

No. 12073

255-7

United States
Court of Appeals
for the Ninth Circuit

J. W. MALONEY, United States Collector of Internal Revenue for the District of Oregon,
Appellant,

vs.

ROSS B. HAMMOND,
Appellee.

Transcript of Record

In Two Volumes

VOLUME I.

(Pages 1 to 336, inclusive)

Appeal from the United States District Court
for the District of Oregon

FILED

MAR - 4 1949

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

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NAMES AND ADDRESSES OF ATTORNEYS

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VICTOR E. HARR,
Assistant U. S. Attorney,
U. S. Court House, Portland, Oregon.

THOMAS R. WINTER,
Special Assistant to the U. S. Attorney,
Smith Tower Building, Seattle, Washington
For Appellant.

ROBERT T. JACOB,

JEROME S. BISCHOFF,

RANDALL S. JONES,
Public Service Building, Portland, Oregon,
For Appellee.

In the District Court of the United States
for the District of Oregon

No. Civ. 3078

ROSS B. HAMMOND,

Plaintiff,

vs.

J. W. MALONEY, United States Collector of Internal Revenue for the District of Oregon,
Defendant.

COMPLAINT

Comes now the Plaintiff herein and for cause of suit against the above named Defendant alleges:

I.

That Plaintiff is an individual taxpayer, resident and domiciled in the State of Oregon, and was during all the times herein mentioned engaged in the general contracting business, as member of a co-partnership, doing business under the firm name and style of Ross B. Hammond Company. Said partnership at all times herein mentioned was composed of Ross B. Hammond and William A. Hammond.

That, at all times herein mentioned, Plaintiff was also engaged in operating a ranch in the State of Oregon.

II.

That at all times herein mentioned, Defendant was and now is United States Collector of Internal Revenue for the District of Oregon, stationed at Portland, Oregon.

III.

Jurisdiction of the within cause rests on the provisions of the Judicial Code of the United States, Section 24, as amended (28 USCA, Subdivision 5, Section 41), and the provisions of Sections 322, 3772, 22 and 23 of the Internal Revenue Code of the United States.

IV.

That the amount in controversy exceeds the sum of \$3000.00. [1*]

V.

That on November 6, 1944, Defendant assessed Plaintiff with a deficiency in income and surtaxes in the sum of \$145,537.77 together with interest in the sum of \$11,609.13, and Plaintiff paid said sums on August 14, 1945 to Defendant.

VI.

That said deficiency assessment and collection was illegal in that Defendant refused to recognize the partnership entity of the Ross B. Hammond Company, and made arbitrary reallocations of income.

VII.

That on or about the 22nd day of August, 1945, Plaintiff filed with the Commissioner of Internal Revenue his claim for refund of said taxes and interest illegally collected and retained; that said claim was in all respects in due and proper form setting forth all of the material facts and grounds upon which said claim for refund was based.

* Page numbering appearing at foot of page of original certified Transcript of Record.

VIII.

That more than six months have elapsed since the filing of the above described claim and the Commissioner has neither allowed nor rejected said claim.

Wherefore, Plaintiff prays for judgment against the Defendant in the principal sum of \$157,146.90 together with interest thereon as provided by law, and for its costs and disbursements incurred herein.

March 15, 1946.

/s/ ROBT. T. JACOB,
/s/ JEROME S. BISCHOFF,
Counsel for Plaintiff.

[Endorsed]: Filed March 16, 1946. [2]

[Title of District Court and Cause.]

ANSWER

The defendant, by his attorneys, Henry L. Hess, United States Attorney for the District of Oregon, and Victor E. Harr, Assistant United States Attorney, and for answer to the complaint on file herein states:

I.

The defendant is without knowledge or information sufficient to form a belief as to the truth of the allegations contained in Paragraphs I to VIII

inclusive, and therefore denies the same and the whole thereof.

Wherefore, defendant asks that the complaint herein be dismissed and that he have his costs and disbursements herein.

HENRY L. HESS,
United States Attorney,
/s/ VICTOR E. HARR,
Assistant United States
Attorney. [3]

(Acknowledgment of Service.)

[Endorsed]: Filed July 19, 1946. [4]

[Title of District Court and Cause.]

NOTICE

To the above-named plaintiff and to Jacob, Jones & Brown, his attorneys:

You and each of you will please take notice that on Monday, October 27, 1947, at the hour of 10 o'clock a.m., or as soon thereafter as counsel may be heard, the defendant will call up for hearing his motion to file an amended answer and to have the United States be made a party to this proceeding, as more fully appears in said motion, proposed amended answer, additional defense and alternative affirmative defense and counter-claim of the defendant and the United States of America,

and affidavit attached thereto, copies of which are herewith being served upon you.

Dated this 17 day of October, 1947.

/s/ HENRY L. HESS,
United States Attorney,

/s/ VICTOR E. HARR,
Assistant United States
Attorney,

/s/ THOMAS R. WINTER,
Special Assistant to the
United States Attorney. [5]

[Title of District Court and Cause.]

MOTION

Comes now the defendant, J. W. Maloney, United States Collector of Internal Revenue, for the District of Oregon, by his attorneys, Henry L. Hess, United States Attorney for the District of Oregon, Victor E. Harr, Assistant United States Attorney, and Thomas R. Winter, Special Assistant to the United States Attorney for said District, and moves the Court for an order authorizing said defendant to file his amended answer herein and to make the United States a party hereto.

Said motion is based upon the files and records

in this case and upon the affidavit of Thomas R. Winter, attached hereto.

Dated this 17th day of October, 1947.

/s/ HENRY L. HESS,

United States Attorney,

/s/ VICTOR E. HARR,

Assistant United States

Attorney,

/s/ THOMAS R. WINTER,

Special Assistant to the

United States Attorney. [6]

State of Washington,

County of King—ss.

AFFIDAVIT

Thomas R. Winter, being first duly sworn on oath, deposes and says:

That he is one of the attorneys for the defendant in the above-entitled action and he is informed and believes that, since the commencement of this action, an investigation of the plaintiff's tax liability for the year 1942 discloses that the income of the alleged partnership for the year 1942 in the amount of \$86,635.88 was not reported by, or taxed to, the plaintiff; that income of the alleged partnership for the year 1943 in the sum of \$77,366.37 was not reported by, or taxed to, the plaintiff; that plaintiff has not overpaid his income taxes for the period involved in the action, but, on the contrary, has underpaid his taxes to the extent of the Federal Income taxes computed on the above additional taxable income; that this action involves a determina-

tion of the plaintiff's total tax liability for the years 1942 and 1943, and the United States, in this action, is entitled, therefore, to appear and affirmatively pray for an affirmative judgment against the plaintiff in the sum of \$6,554.03, with interest from November 21, 1945, and costs, as will more fully appear in the defendant's Amended Answer and Counter-Claim of the United States of America; that the United States is a necessary party to this action in order that the Court may fully determine the issues involved, and the appearance of the United States in this action will avoid a multiplicity of suits.

/s/ THOMAS R. WINTER.

Subscribed and sworn to before me this 16th day of Oct., 1947.

(Seal) /s/ PHILIP TINDALL,
Notary Public in and for the State of Washington,
residing in Seattle.

[Endorsed]: Filed October 17, 1947.

[7]

[Title of District Court and Cause.]

OBJECTIONS TO THE MOTION OF DEFENDANT FOR LEAVE TO FILE AN AMENDED ANSWER

Comes now plaintiff above named and objects to the motion of defendant dated October 17, 1947, for leave to file the amended answer tendered with the said motion, on the following grounds:

1. Defendant fails to make any showing that the failure to incorporate the new matter in the original

answer was due to excusable mistake, inadvertence or neglect.

2. Defendant fails to make any showing of diligence to ascertain the matters now tendered by the amended answer.

3. The counter-claim or set-offs denominated "additional defense" and "alternative affirmative defense and counter-claim" introduces for the first time entirely new causes of action by the defendant against the plaintiff.

4. The said counter-claims and set-offs denominated "additional defense" and "alternative affirmative defense and counter-claim" are barred by the Statute of Limitations incorporated into the Internal Revenue Act (Section 275 of the Internal Revenue Act, Title 26, U.S.C.A., Section 275, subdivision (a).)

These objections are based upon the records and files of this cause filed herein and upon the affidavit of Robert T. Jacob, verified October 24, 1947, filed simultaneously herewith.

Dated October 24, 1947.

/s/ ROBERT T. JACOB,

/s/ S. J. BISCHOFF,

Attorneys for Plaintiff. [8]

AFFIDAVIT

State of Oregon,

County of Multnomah—ss.

I, Robert T. Jacob, being duly sworn, on oath depose and say that I am one of the attorneys for the plaintiff in the above entitled action and I am familiar with the facts and circumstances out of

which the cause of action set forth in the pleadings arose and with all of the proceedings had and taken herein.

The cause of action set forth in the complaint is for the recovery of a refund of income tax for the year 1943 paid by the plaintiff to the defendant pursuant to an assessment made by the Commissioner of Internal Revenue on July 27, 1945. The assessment of the tax was made pursuant to a Revenue Agent's report and a proposal of an assessment made by the Commissioner of Internal Revenue on November 6, 1944.

The chronological order of the proceedings in this cause is as follows:

March 16, 1946: Complaint filed.

May 16, 1946: Motion by defendant for 30 days extension to file answer.

May 20, 1946: Order granting 30 days extension to file answer.

June 14, 1946: Motion by defendant for an additional 30 days extension to file answer.

June 17, 1946: Order granting said Motion. [9]

July 19, 1946: Answer filed by defendant, consisting of a general denial, without any affirmative defense, counter-claim or set-off.

October 7, 1946: Order setting pre-trial November 12, 1946.

October 28, 1946: Order cancelling pre-trial and resetting pre-trial November 25, 1946.

November 25, 1946: Order resetting pre-trial to January 6, 1947.

December 23, 1946: Order resetting pre-trial to January 2, 1947.

January 2, 1947: Order striking case from pre-trial and trial calendars.

October 18, 1947: Present motion for leave to file amended answer and counter-claims and set-off in this cause, accompanied by proposed amended answer.

To provide the court with an explanation of the relationship between the issues tendered by the original pleadings and the new issues now sought to be raised by the Amended Answer, counter-claims and set-offs, I set forth herein the following facts:

The Revenue Agent's report upon which the deficiency in income taxes was assessed and paid did not assert or charge the plaintiff (taxpayer) or his partnership with withholding from their income tax returns any item of revenue or gross income received or accrued in the tax years in question; neither did the report upon which the assessment was made charge the plaintiff (taxpayer) or his partnership with including in their returns any unallowable items of expense or deduction.

The sole basis for the assessment set forth in said report was

(a) The claim that W. A. Hammond was not a partner with plaintiff and that all income from the business of Ross B. Hammond Company should be charged to plaintiff, and

(b) In said report, the agent shifted the in-

come and expenses of the years 1941, 1942, 1943 and 1944 from one year to [10] another by arbitrarily applying the "percentage of completion" method of accounting to the business of the taxpayer and his partnership instead of applying the accrual method of accounting as employed by them.

Said agent's report and the assessment based thereon were not predicated upon any of the factors or issues now tendered in the amended answer as a basis for a counter-claim and set-off, but the issues now tendered are entirely new and involve solely the question whether the compensation (share of profits) to be paid to the employees, Mason and Peterson, was properly accrued in the years reported by the taxpayer. No such controversy was presented by the Revenue Agent's report of November 6, 1944, or by the assessment notice based thereon.

The right of the Commissioner of Internal Revenue to assess any deficiency in tax against the plaintiff by reason of the facts set forth in the counter-claim and set-off expired on March 15, 1944, by virtue of Section 275 of the Internal Revenue Act, Title 26 U.S.C.A., Section 275, Subdivision (a).

No assessment of such tax was made by the Commissioner of Internal Revenue on or before said date and the Commissioner is now barred from raising any question in respect to the matters set forth in the counter-claim and set-off, and was so barred on October 17, 1947, when the motion for leave to file the Amended Answer, counter-claim and set-off was filed herein.

All of the matters set forth in the said amended answer, counter-claim and set-off were well known to the defendant, the Internal Revenue Bureau and its agents on November 6, 1944, at the time said report and proposal of settlement were made. The issue now sought to be raised arises out of the relation between the employees, Mason and Peterson, and the plaintiff and the partnership of which he was a member by virtue of written profit sharing agreements between the parties, and involves the question of the year in which their earnings [11] by way of a share of profits could properly be accrued for tax purposes by the plaintiff and his partnership. The relationship between the said parties was well known to the Revenue Agent who made the said report; the contracts were examined by him during the course of his investigations; the manner in which their profit sharing earnings were carried on the books of the plaintiff and his partnership was known to the Revenue Agent and examined by him during the course of the examination resulting in the said report; his said report of November 6, 1944, discusses the said relationship and the accrual of the earnings of the said Mason and Peterson and discusses all facts and circumstances pertaining to the said relationship and the manner in which the accounts were carried on the books of the plaintiff and his partnership, and the manner in which they were treated for income tax purposes was fully investigated and known to the Revenue Agent making said investigation and report at the time thereof.

Subsequent to the payment of the deficiency assessed pursuant to said report and the commencement of this action to recover the refund, the accounts pertaining to the matters referred to in the counter-claim and set-off were the subject of discussion between counsel for the respective parties and the agents of the government, and at the suggestion of counsel for the defendant, I submitted a proposal of settlement on behalf of the plaintiff in which specific mention of this issue was made. These negotiations and the proposal of settlement preceded December 21, 1946.

In the said proposal of settlement submitted at the request of counsel of defendant as aforesaid, dated December 21, 1946, I set forth, among other things, the following as a basis of settlement:

“2. The division of profits to be made by the Ross B. Hammond Company to H. M. Mason and A. V. Peterson to be accrued in accordance with the income of Ross B. Hammond as adjusted in the R.A.R. dated November 6, 1944.” [12]

* * *

“We have checked the adjustments and tax computations made by Internal Revenue Agent Williams (the agent who made said report of November 6, 1944) to give effect to the adjustments necessary to comply with the terms of this offer, and have found them to be **correct and acceptable** to us as a basis for the settlement.”

This is the same manner that is now referred to in the said counter-claim and off-set and the adjustments and tax computations referred to in said

offer of settlement took into account the accruals of the Mason and Peterson shares of profits.

In the Revenue Agent's report of November 6, 1944, paragraph 10, Schedule 3A, he says, among other things:

“Under date of February 3, 1942, Ross B. Hammond entered into agreements with H. M. Mason and A. V. Peterson, whereby Mason and Peterson were to participate in the profits of Ross B. Hammond Company in the ratio of 20% in the case of Mason and 15% in the case of Peterson. These agreements were entered into by Ross B. Hammond as an individual.”

Throughout the said report he referred to and discussed the said contracts with Mason and Peterson and their profit sharing arrangements and in no way challenged the deductibility of their profit sharing allowances for the years in question.

I am aware of no fact or circumstance which would justify the long delay of the defendant and of the government agency in asserting the contentions now advanced by the said counter-claim and set-off.

/s/ ROBERT T. JACOB.

Subscribed and sworn to before me this 24 day of October, 1947.

(Seal) /s/ J. F. JOHNSON,

Notary Public for Oregon.

My Commission expires: 3/29/51.

[Endorsed]: Filed October 27, 1947. [13]

[Title of District Court and Cause.]

PETITION OF THE UNITED STATES
FOR LEAVE TO INTERVENE

The United States of America, by its attorneys, Henry L. Hess, United States Attorney for the District of Oregon, Victor E. Harr, Assistant United States Attorney, and Thomas R. Winter, Special Assistant to the United States Attorney for said District, respectfully alleges and shows:

I.

That the petitioner is a corporation sovereign and body politic.

II.

That the intervention herein prayed is authorized by the Attorney General of the United States of America, at the request of the United States Commissioner of Internal Revenue.

III.

That the United States has an interest in the matter being litigated in this suit and is a necessary and proper party to the complete determination thereof.

IV.

That the facts with respect to the petitioner's interest in this cause are fully set forth in the Amended Answer, Additional Defense and all Affirmative Defense and Counter [14] Claim of the above-named defendant and this petitioner, which have been heretofore served on the plaintiff herein and submitted to the Court, and by reference made a part hereof.

V.

That no application for relief herein has been made to any **Court or Judge, except as stated above.**

Wherefore, petitioner prays that an order be made granting it leave to intervene herein as additional party and to file its said amended answer, additional defense and alternative defense and counter-claim and directing that service of said amended answer, additional defense and alternative defense and counter claim may be made by delivering a copy thereof to the attorneys for the plaintiff and requiring plaintiff herein to answer said amended answer, additional defense, and alternative defense and counter-claim if he be so advised within twenty days after the service of such order.

/s/ HENRY L. HESS,

United States Attorney,

/s/ VICTOR E. HARR,

Assistant United States
Attorney,

/s/ THOMAS R. WINTER,

Special Assistant to the
United States Attorney.

(Acknowledgment of Service.)

[Endorsed]: Filed Oct. 31, 1947. [15]

[Title of District Court and Cause.]

OBJECTION TO PETITION FOR
INTERVENTION

Comes now the plaintiff above named and objects to the petition of the United States for an order

granting it leave to intervene in this action as a party thereto and for leave to file the tendered amended answer on the ground and for the reason that:

1. The petition fails to disclose that the United States is entitled to intervene under any of the provisions of Rule 24 of the Federal Rules of Civil Procedure.

2. There is no need for intervention by the United States in order to recover the refund referred to in the "Alternative Affirmative Defense and Counterclaim" set forth in the tendered amended answer. The court is authorized and required to grant the relief prayed for in said alternative affirmative defense and counterclaim by the provisions of Title 26, Section 3801, U.S.C.A., if a judgment is rendered for the plaintiff herein for the relief prayed for in the complaint.

Dated November 7, 1947.

/s/ ROBERT T. JACOB,

/s/ S. J. BISCHOFF,

Attorneys for Plaintiff.

(Acknowledgment of Service.)

[Endorsed]: Filed Nov. 10, 1947. [16]

[Title of District Court and Cause.]

ORDER

The above-entitled cause having duly come on for hearing on the motion of the defendant for an order permitting defendant to file the amended an-

swer attached to said motion and to make the United States a party hereto, and upon the petition of the United States for leave to intervene as an additional party to this suit and to file its amended answer, additional defense and alternative defense and counterclaim attached to the aforesaid motion for leave to amend, the defendant and the United States appeared herein by Thomas R. Winter, Special Assistant to the United States Attorney in support of said motion and petition, the plaintiff appeared herein by Robert T. Jacob and S. J. Bischoff in opposition thereto, the court having heard the arguments and considered the affidavits and petitions filed herein by the respective parties, it is

Ordered that the objections filed by the plaintiff to the said motions and petition be and the same hereby are sustained and the said motions and petitions are hereby denied.

Dated November 14th, 1947.

/s/ CLAUDE McCOLLOCH,
Judge.

[Endorsed]: Filed Nov. 14, 1947. [17]

[Title of District Court and Cause.]

FINDINGS OF FACT AND CONCLUSIONS OF LAW

This cause duly came on for trial on January 12th to January 16th, 1948. The plaintiff appeared herein in person and by Robert T. Jacob and S. J. Bischoff, his attorneys, the defendant appeared herein by Thomas R. Winter, Special Assistant to

the United States Attorney. Evidence was introduced by the parties hereto and the cause was thereupon taken under advisement.

The court now makes and files herein the following

FINDINGS OF FACT

1.

That at all the times herein set forth the plaintiff was an individual taxpayer and resident and domiciled in the State of Oregon and was during all of the times herein mentioned engaged in the general contracting business.

2.

That at all the times herein mentioned, defendant, J. W. Maloney, was the United States Collector of Internal Revenue for the District of Oregon.

3.

Jurisdiction of the above-entitled cause is based on the provisions of Section 24 of the Judicial Court (28 U.S.C.A.), Section 41, Subdivision 5, and the provisions of Sections 22, 23, 322 and 3772 of the Internal Revenue Code of the United States.

4.

The amount in controversy exceeds the sum of \$3,000.00.

5.

On July 27, 1945, the Commissioner of Internal Revenue of the United States assessed against plaintiff a deficiency in income and surtaxes for the taxable year 1943 in the sum of \$145,537.77, together with interest thereon in the sum of \$11,609.13, being a total of \$157,146.90.

6.

Plaintiff paid the said sum as follows: \$150,592.88 was paid in cash on August 17, 1945, and \$6,554.03 was paid by credit allowed for refund on account of overassessment for the year 1941.

7.

That the aforesaid deficiency in income and surtax and the collection thereof by defendant was illegal.

8.

That on August 22, 1945, plaintiff filed with the Commissioner of Internal Revenue a claim for refund of the said taxes and interest illegally collected and retained; that said claim was in all respects in due and proper form and at the time of the commencement of this action more than six months had expired since the filing of said claim for refund and the Commissioner of Internal Revenue had neither allowed or rejected the said claim prior to the commencement of this action.

9.

That the determination of the aforesaid deficiency in income and surtaxes by the Commissioner of Internal Revenue was based upon the report of the Revenue Agent, W. G. Williams, dated November 6, 1944 (Plaintiff's Exhibit 20) and the reasons set forth therein; that the deficiency assessment was due in part to the refusal of the Commissioner to recognize the existence of a partnership between the plaintiff above named and William A. Hammond during the tax years 1942 and 1943 and in part to

the rejection by the Commissioner of [19] the partnership's method of accounting of the income from the partnership business and reporting the income in the income tax returns for said years. More specifically the Commissioner rejected the accrual method of accounting maintained by the partnership and the plaintiff and substituted ^{another} a ~~hybrid~~ [C. McC.] method of accounting based in part upon the accrual method, in part on the percentage of profit method and in part upon completed contract basis.

10.

The plaintiff and William A. Hammond are respectively father and son. William A. Hammond is the only son of plaintiff and his wife. Plaintiff was engaged in the contracting business all his life and had become a very successful and prominent contractor. William A. Hammond was 24 years of age and married when the partnership was formed. The education of his son William was channeled from the earliest childhood to prepare him to engage in the contracting business. It was William's own choice as well. To that end father and son worked together at all times. While a young man and going to grammar and high school the son spent all of his spare time with his father on the various construction jobs that were being carried on, receiving training in that work. Upon graduation from high school, the son went to a university and was graduated as a civil engineer. He immediately went to work for his father performing work which required skill, intelligence and knowledge. On February 3, 1942, plaintiff and Wil-

liam A. Hammond entered into a written partnership agreement by the terms of which the partnership was to continue during their joint lives. The interest of the plaintiff was to be 75 per cent and of William A. Hammond 25 per cent. They were to share in the profits and losses upon that basis. It was provided that each of the partners shall have an equal voice in the control of the business and operation of the partners, that accurate books of account should be kept, that upon dissolution of the partnership or death of either of the partners, the business [20] should be wound up, the debts paid and the surplus divided according to their aforesaid interests in the partnership. They agreed that plaintiff should not withdraw from the partnership any more than \$22,500.00 a year and William A. Hammond \$7,500.00 a year and that the excess earnings should be permitted to remain and be used as working capital of the company.

11.

This partnership agreement was entered into at that time because William A. Hammond intended to go to Brazil and engage in the contracting business there. Plaintiff and his wife were eager for their son to remain in Portland and to engage in the contracting business with the plaintiff. Plaintiff persuaded William A. Hammond to refrain from going to Brazil by taking him into the partnership with him at that time.

12.

After the written partnership agreement was entered into and executed on February 3, 1942, the

son was made General Manager of the partnership business, suitable offices were set up for him in the offices of the Company, his activities were greatly increased, he acted as chief engineer for large projects with a large staff of engineers under him. He personally negotiated the contracts for large construction jobs, supervised the work of making bids on the contracts and did a great deal of work that required great responsibility as well as knowledge, experience and ability and in every respect performed functions normally performed by the partner in the management, operation and control of the business. The court finds that the partnership agreement was actually entered into, that it was made in good faith, that it was actually carried out thereafter in good faith and that the said William A. Hammond contributed substantially to the control and management of the business and performed vital additional services which contributed substantially to the production of the income of the business during all of the [21] tax years in question.

13.

At the time that the partnership was entered into between plaintiff and his son, as aforesaid, it was determined by them to keep the said partnership agreement secret between them for the time being because two of the key employees of the plaintiff who were essential to the successful operation of the business were insisting upon being given a partnership interest in the business. Plaintiff was unwilling to take them into partnership with him

and it was feared that if the formation of the partnership between plaintiff and his son were disclosed that these two men would terminate their employment, creating very serious impairment to the business. Because of the agreement to maintain secrecy, it was necessary for the plaintiff to continue to take all contracts in his own name and ostensibly carry on the business in his name. The court finds that the secrecy was maintained for a valid business reason and not for any fraudulent or unlawful purpose and as soon as the need for secrecy disappeared the existence of the partnership was made public.

14.

Prior to the tax year 1938 plaintiff conducted his contracting business in the name of a corporation. The corporation kept its books and reported its income on a percentage of completion basis but plaintiff individually kept his records and reported his personal income on the cash basis. The corporation was dissolved as of the end of the year 1938 and thereafter and until the formation of the said partnership the plaintiff conducted the contracting business in his own name. At the time of the dissolution of the corporation, the corporation had been engaged in the construction of the State Capitol Building for the State of Oregon at Salem, Oregon. Upon dissolution of the corporation, plaintiff individually completed the construction of that project. In 1937 the corporation reported the income from that project on the percentage of completion basis. In 1938, plaintiff applied to the Commis-

sioner of Internal Revenue for permission [22] to adopt individually the accrual method of accounting except as to the income to be reported from the completion of State Capitol building project. He excepted that project from the accrual method and requested permission to report the remainder of that project on the percentage of completion method in order that the method of accounting as to that particular project should be consistent.

15.

In 1938 the Commissioner of Internal Revenue granted to the plaintiff permission to maintain his accounts and to report his income on the accrual method except as to the remainder of the State Capitol project and the court finds that plaintiff did in and after 1938 maintain his accounts and reported his income to the Commissioner of Internal Revenue upon the accrual method except that in 1938 he reported the balance of the State Capitol project on the completion method of accounting.

16.

That during all of the time since 1938 to and including the tax years in question the plaintiff and the said partnership uniformly adopted and maintained the accrual method of accounting and reported their income to the Commissioner of Internal Revenue upon that method of accounting; that no change was made by them in the method of accounting and reporting income during all of said time.

17.

The court finds that the accounts were honestly, straightforwardly, frankly and fairly kept and maintained during all of the tax years in question, the accounts clearly reflected the income of the partnership and of the plaintiff and that the method of accounting was not maintained or carried on with any purpose of evading or minimizing plaintiff's tax liability. [23]

18.

The court finds that during the tax years in question, plaintiff and the said partnership accrued on their books all income which they had the right to receive and accrued as deductions all liabilities incurred for expense in the operation of the business and that all accruals of income and of deductions were properly entered upon the books of the partnership and were properly reflected in the income tax reports in the tax years in question, that the Commissioner of Internal Revenue had no basis in fact or in law for the rejection of plaintiff's method of accounting and reporting the income for the tax years in question and the substitution of another method and that the method of accounting employed by the Commissioner of Internal Revenue was in ~~any event~~ [C. McC.] an improper method of accounting since it was partly accrual and partly transactional being based in part upon the accrual basis adopted by plaintiff and in part upon the percentage of profit basis and in part upon the completion of contract basis.

On February 3, 1942, plaintiff entered into a profit sharing agreement with an employee, Henry M. Mason, in words and figures as follows:

“AGREEMENT OF EMPLOYMENT

This Agreement, made and entered into on this 3rd day of February, 1942, by and between Ross B. Hammond, sole proprietor, doing business as Ross B. Hammond Co., hereinafter called “First Party,” and Henry M. Mason, hereinafter called “Second Party.”

Witnesseth:

Whereas the Second Party has been in the employ of the First Party almost continuously for a period of thirteen years, and the First Party recognizing the value of the services, ability, and trustworthiness of the Second Party, and the First Party wishing to permit the Second Party to participate in the profits of the First Party’s contracting business; and

Whereas, the Second Party has been acting as General Superintendent and General Manager of the construction business of the First Party, with full power of attorney to sign all documents, and subject [24] only to direction of the First Party; and

Whereas, the Second Party has been acting as General Superintendent and General Manager of the construction business of the First Party, with full power of attorney to sign all documents, and

subject only to direction of the First Party; and

Whereas the First Party wishing to have the Second Party assume a greater responsibility in connection with the management of the general contracting activities of the First Party;

Now, Therefore, the Parties hereto, agree as follows:

1. Compensation of Second Party and Method of Payment: The First Party hereby agrees that he will pay for the services of the Second Party by permitting him to participate in the net profits of the operation of the First Party's construction business upon the basis of twenty (20) per cent of the profits earned each calendar year, after all operating, financing, administrative, and other like expenses have been deducted, but before deduction of State and Federal Income Taxes.

It is specifically understood and recognized between the parties that the operations of this business require the use of large sums of money to be available for financing the operation of the construction and contracting business, and, therefore, to insure the continued success of the business and to provide ample working capital, it is hereby agreed that the earnings of the Second Party shall be paid to him on a basis of a drawing account of Five Hundred (\$500.00) Dollars per month, but the Second Party will not be permitted to withdraw in excess of Ten Thousand Dollars (\$10,000.00) per year. Any funds amounting to more than \$10,000.00 per year shall be permitted to remain in the company, to be used for working capital for use in

that shall be permitted to remain under the control of the First Party for financing and working capital of the construction business of the First Party shall bear no interest.

2. Cancellation: This agreement may be cancelled by either party giving the other party 90 days' written notice, and/or the same may be changed or modified at any time by mutual consent of the parties hereto. It is further understood and agreed that said contract will be automatically cancelled if the said Second Party should leave the employ of the First Party of his own accord.

The Second Party further expressly agrees that should he sever his connection with First Party and desire to withdraw the earnings accumulated to his account, he will give one year's written notice thereof to the First Party, and the First Party will not be obligated to pay such funds to the Second Party until one year after receipt of said written notice [25] from the Second Party.

Should Second Party elect to cancel this agreement or voluntarily leave the service of the First Party, then, and in either event, Second Party shall not receive any percentage of any profit earned by the First Party upon any work done or any contracts entered into during such calendar year, and the payment to the said Second Party of an amount equal to \$500.00 per month for the time employed during such current calendar year shall constitute full and complete payment for all services and/or

the use of the funds of the said Second Party for said current calendar year.

Should the First Party desire to cancel this agreement, he shall notify the Second Party in writing ninety (90) days prior to the date of such cancellation and the compensation due the Second Party shall be upon the basis of twenty (20) per cent of the net profits, as described in paragraph 1 hereof, as shown by the books of the First Party, from January 1st of that year to the date of written notice of cancellation, plus \$1,500.00 to cover compensation for the 90 days employment service from the date of the written notice.

3. Drawing Account: Should the drawing account of \$500.00 per month, or \$6,000.00 per year, as defined in Paragraph 1 above, exceed in any calendar year the percentage of profits to which the Second Party is entitled under this agreement, this difference between the amount of money to which the Second Party is entitled for his services on the basis of this agreement, as outlined in Paragraph 1, shall be charged against any moneys which have accrued to the account of the Second Party, and the amount of money owing the Second Party by the First Party shall be reduced by this amount.

4. Nature of Agreement: It is expressly understood and agreed by and between the parties hereto that this agreement is a contract of employment and that the Second Party does not hereby acquire a proprietary interest in the business of the First Party, but the amounts paid to Second Party shall represent compensation for services rendered.

In Witness Whereof, the parties hereto have affixed their names and seals to the within agreement on the day and date first above given.

ROSS B. HAMMOND CO.

By /s/ R. B. HAMMOND,
First Party.

/s/ H. M. MASON,
Second Party.

Subscribed and sworn to before me, the undersigned, a Notary Public, on this 3rd day of February, 1942.

/s/ ROSALIE NOVAK,
Notary Public for Oregon.

My Commission expires 10/21/42." [26]

20.

On the same date plaintiff entered into a profit sharing agreement with an employee, A. V. Peterson, which is the same as the foregoing contract except that the share of the profits was to be 15 per cent and the monthly withdrawal was limited to \$400.00 per month with a maximum annual withdrawal of \$7,500.00 per year.

21.

During the tax year 1942, the share of the profits earned by the said Mason and Peterson computed in accordance with the terms of the said contracts was the sum of \$86,635.88 and for the tax year 1943 the share of the profits earned by the said Mason and Peterson computed in accordance with the said contracts was the sum of \$77,366.37. That

the share of the profits of the said Mason and Peterson for said tax years was computed upon the same basis as the plaintiff's profits were computed in accordance with the method of accounting employed by plaintiff and in accordance with the income reported by the plaintiff to the Commissioner of Internal Revenue. That the share of the profits earned by the said Mason and Peterson in said years was credited to their accounts in the said tax years and accrued on the books of the company and said profits were charged against the contracts upon which the said Mason and Peterson performed their services in order to determine the profit or loss from said contracts in the said tax years.

22.

The court finds that the said contracts were actually entered into on said dates, that they were made in good faith, that the said employees earned in said years the amount of the profits credited to them and accrued on the books in said years, that the profits so accrued to them were proper deductions in the said tax years as expense in reporting plaintiff's income for the tax years 1942-1943; that said profits were subsequently paid to them in cash, and that there is no basis in fact or in law for the disallowance of those two items as deductions in the said two tax years. [27]

23.

The court finds that when the Revenue Agent made the examination of plaintiff's books in Au-

gust, 1944, resulting in his report dated November 6, 1944 (Plaintiff's Exhibit 20), the Revenue Agent examined the said contracts and had knowledge of all of the facts pertaining to the deduction of the share of the profits accrued to them in the said two tax years in question, that he examined into the propriety of the said deductions and that the said Revenue Agent in said report did not disallow or reject the said deductions by reason of the accrual of the Mason and Peterson share of the profits as deductions and the Commissioner of Internal Revenue did not determine and assess any deficiency in income tax by reason of said transactions.

24.

This action for refund was commenced on March 16, 1946. On July 19, 1946, defendant interposed its answer herein consisting of a general denial but did not set up any counterclaim, set-off or defense predicated upon the claim that Mason's and Peterson's share of the profits accrued in 1942 and 1943 were improperly taken as deductions. On October 18, 1947, defendant filed a motion herein for leave to file an amended answer in which for the first time it was claimed that the said items should not be allowed as a deduction in those tax years and that the income tax of the plaintiff should be re-computed by increasing its income by said amounts. Plaintiff objected to the allowance of the motion on the ground that the defendant failed to make any showing why the matters tendered by said pro-

posed amended answer were not presented at an earlier date; that there was no showing of due diligence; that the said amendment introduced a new cause of action by the defendant against the plaintiff; and that the set-off denominated "Additional Defense" was barred by the statute of limitations contained in the Internal Revenue Code. After extensive hearing upon said motion and objections, an order was entered herein on November 14, 1947, overruling defendant's motion for leave to interpose said set-off. This order [28] was made on all of the grounds stated in the said objections. Upon the trial of the action, the court permitted evidence to be introduced upon said issue subject to plaintiff's objection and has reconsidered all of the objections heretofore made in the light of the evidence introduced upon the trial and the court now finds that all of the said objections were well taken and also finds that upon the merits the share of the profits credited on the books of the plaintiff and the partnership to the said Mason and Peterson and accrued as expense and deductions were in any event properly entered and taken.

25.

The court finds that the deficiency in income tax assessed by the Commissioner of Internal Revenue as aforesaid and collected by the defendant as aforesaid were illegal and that plaintiff is entitled to recover the said payments with interest thereon at the rate of six per cent per annum from the date that the collector received payment thereof.

26.

In determining the deficiency in income tax and surtaxes for the year 1943 which resulted in the aforesaid unlawful assessment and collection, the Commissioner of Internal Revenue determined that a part of the income reported by plaintiff for the tax year 1941 was erroneously included in that year and that said portion should have been included in the subsequent tax years of 1942 and 1943 and by reason thereof the Commissioner of Internal Revenue determined that taxpayer was entitled to a refund of a portion of the income tax paid in 1941 to the extent of \$6,554.03. When the defendant collected the aforesaid unlawful assesment of the sum of \$157,146.90, he allowed a credit to the plaintiff on account thereof to the extent of \$6,554.03 which should have been paid to the plaintiff as a refund under the Commissioner's determination and accepted in addition to said credit the aforesaid sum of [29] \$150,592.88 in payment of the aforesaid unlawful assessment. Subsequent to the commencement of this action, the United States of America commenced an action in this court against Ross B. Hammond, the plaintiff above named, Civil Action No. 3964, for the recovery of the aforesaid sum of \$6,554.03 in the event that this court determines in this action that plaintiff is entitled to recover the full sum of \$157,146.90. Upon the trial of the action, it was stipulated in effect that instead of trying the aforesaid action, No. 3964, adjustment shall be made with respect to the said credit of \$6,554.03 in accordance with the ulti-

mate determination of the court in this action. Since plaintiff only paid the sum of \$150,592.88 and received credit for the said sum of \$6,554.03, plaintiff is entitled to recover herein the sum of \$150,592.88 with interest thereon at the rate of six per cent per annum from the aforesaid date of payment and is entitled to the entry of a judgment dismissing the aforesaid action No. 3964 with prejudice.

Upon the foregoing findings of fact, the court makes and files herein the following

CONCLUSIONS OF LAW

1. That plaintiff has sustained the allegations of the complaint by a preponderance of the evidence.

2. That the deficiency in income tax and surtaxes assessed against and collected from the plaintiff were unlawful, ~~arbitrary~~ [C. McC.] and without just cause.

3. That plaintiff and the partnership of which he was a member had the right to maintain their accounts on the accrual method of accounting and to report their income on said basis during the tax years in question.

4. That the books of account of the plaintiff, during the tax years in question, were maintained on a true and accurate accrual basis and that his income tax reports were made on a true and correct accrual basis in accordance with the said accounting [30] method.

5. That the Commissioner of Internal Revenue had no authority under the facts in this case to reject plaintiff's method of accounting and to substitute another method.

6. That plaintiff's method of accounting and reporting income clearly reflected the income during the tax years in question.

7. That the method of accounting employed by the Commissioner of Internal Revenue was not authorized or warranted by any provision of the Internal Revenue Code or Regulations.

8. That the partnership agreement entered into between plaintiff and William A. Hammond was entered into and carried out in good faith, the business of the said partnership was carried on by them as co-partners during the tax years in question and the Commissioner of Internal Revenue was not justified in rejecting the said partnership in computing plaintiff's income tax liability for the tax years in question.

9. The defendant is not entitled to set-off against plaintiff's claim for refund any claim for additional tax arising out of the accrual of the Mason and Peterson share of the profits in the tax years in question because (a) the said set-off was not interposed timely and no showing of diligence for the failure to do so was made to the court, (b) the right of the Commissioner of Internal Revenue to assess additional tax by reason of said transactions was barred by the statute of limitations at the time defendant attempted to interpose the set-off (the Com-

missioner of Internal Revenue did not at any time make any determination or assessment of any deficiency in income tax by reason of said transactions), and (c) upon the merits the Commissioner of Internal Revenue could not have lawfully assessed any deficiency in income tax by reason thereof.

10. Plaintiff is entitled to recover from the defendant the taxes unlawfully collected from the plaintiff as set forth in the findings of fact. [31]

11. The court directs that judgment be entered in favor of the plaintiff and against the defendant for the sum of \$150,592.88 with interest thereon at the rate of six per cent per annum from August 17, 1945, together with his costs and disbursements incurred herein and for the entry of a judgment in the action No. 3964 dismissing said action with prejudice. The foregoing shall be an opinion within 28 U.S.C.A. Sec. 764.

Dated: April 21st, 1948.

/s/ CLAUDE McCOLLOCH,
Judge.

Service of the within Findings of Fact and Conclusions of Law by receipt of a duly certified copy thereof, as required by law is hereby accepted in Multnomah County, Oregon, on this 21st day of April, 1948.

/s/ VICTOR E. HARR,
Attorney for Defendant.

[Endorsed]: Filed April 21, 1948. [32]

In the District Court of the United States
for the District of Oregon

Civil No. 3078

ROSS B. HAMMOND,

Plaintiff,

vs.

J. W. MALONEY, United States Collector of Internal Revenue for the District of Oregon,

Defendant.

JUDGMENT

This cause having duly come on for trial on January 12th to January 16th, 1948, the plaintiff appeared herein in person and by Robert T. Jacob and S. J. Bischoff, his attorneys, the defendant appeared herein, by Thomas R. Winter, Special Assistant to the United States Attorney, Findings of Fact and Conclusions of Law have been made, filed and entered herein, now on motion of S. J. Bischoff, attorney for the plaintiff, it is

Considered, Ordered and Adjudged that the plaintiff, Ross B. Hammond, do have judgment for and recover of and from the defendant, J. W. Maloney, United States Collector of Internal Revenue for the District of Oregon, the sum of \$150,592.88, with interest thereon at the rate of six per cent per annum from August 17, 1945, making a total of \$174,788.14, together with the costs and disburse-

ments incurred by the plaintiff in the sum of \$353.89 as taxed by the Clerk of this Court.

Dated April 21st, 1948.

CLAUDE McCOLLOCH,
Judge.

Entered in docket April 21, 1948.

[Endorsed]: Filed April 21, 1948. [33]

[Title of District Court and Cause.]

NOTICE OF APPEAL

To: Ross B. Hammond, plaintiff above-named, and
Messrs. Robert T. Jacob and S. J. Bischoff, at-
torneys for plaintiff.

You and each of you will please take notice that the defendant, J. W. Maloney, United States Collector of Internal Revenue for the District of Oregon, appeals to the Circuit Court of Appeals for the Ninth Circuit, from that certain judgment in the above-entitled cause made and entered the 21st day of April, 1948, by the Honorable Claude McCulloch, Judge of the above-entitled court, wherein the plaintiff recovered judgment from the defendant in the sum of \$150,592.88, with interest thereon at the rate of six per cent per annum from August 17, 1945, making a total of \$174,788.14, together with the costs and disbursements incurred by the plaintiff in the sum of \$353.89.

Dated this 15th day of June, 1948, at Portland,
Oregon.

HENRY L. HESS,

United States Attorney for
the District of Oregon.

/s/ VICTOR E. HARR,

Assistant United States
Attorney.

[Endorsed]:Filed June 18, 1948. [34]

In the United States Circuit Court of Appeals
for the Ninth Circuit

Civ. No. 3078

J. W. MALONEY, United States Collector of In-
ternal Revenue for the District of Oregon,
Appellant,

vs.

ROSS B. HAMMOND,

Appellee.

ORDER

This matter coming on to be heard upon motion of Henry L. Hess, United States Attorney for the District of Oregon, and Victor E. Harr, Assistant United States Attorney, for an order extending the time ninety (90) days from the first date of notice of appeal herein for filing the record on appeal and docketing the action, and the Court having considered said motion and the supporting affidavit filed therewith, and being advised, it is

Ordered that the appellant be and he is hereby granted an extension of ninety (90) days from the

date of filing notice of appeal within which to file and docket the record on appeal.

Dated at San Francisco, California, this 16th day of July, 1948.

/s/ FRANCIS A. GARRACHT,
Judge.

A True Copy.

Attest: July 16, 1948.

[Seal] /s/ PAUL P. O'BRIEN,
Clerk.

[Endorsed]: Filed July 16, 1948. Paul P. O'Brien, Clerk.

MOTION

Comes now Henry L. Hess, United States Attorney for the District of Oregon, and Victor E. Harr, Assistant United States Attorney, and based upon attached affidavit moves the Court for an order extending the time for filing the record on appeal and docketing the action, granting to appellant ninety (90) days from June 18, 1948. This motion is based upon Rule 73, Rules of Civil Procedure.

Dated at Portland, Oregon, this 15th day of July, 1948.

HENRY L. HESS,
United States Attorney for
the District of Oregon.

/s/ VICTOR E. HARR,
Assistant United States
Attorney. [36]

[Endorsed]: Filed July 22, 1948. [35]

AFFIDAVIT

United States of America,

District of Oregon—ss.

I, Victor E. Harr, being first duly sworn, depose and say that I am Assistant United States Attorney for the District of Oregon; that I am one of the attorneys of record representing defendant in the case in the District Court of the United States for the District of Oregon, entitled, “Ross B. Hammond v. J. W. Maloney, Collector of Internal Revenue for the District of Oregon, Civil No. 3078”; that Notice of Appeal was duly filed in said cause on the 18th day of June, 1948. The Department of Justice is presently considering the evidence aduced at the trial of the above-named cause, including the partnership issue, the accounting issue, and the issue involving the agreement with the employees, with a view of determining whether or not this appeal will be prosecuted. This affidavit is made in support of a motion for extension of time within which to file the record and docket the appeal.

Dated at Portland, Oregon, this 15th day of July, 1948.

/s/ VICTOR E. HARR.

Subscribed and sworn to before me this 15th day of July, 1948.

[Seal] /s/ FLORENCE McKAY,

Notary Public for Oregon.

My Commission Expires: Sept. 4, 1951. [37]

[Title of U. S. Court of Appeals and Cause.]

ORDER

This matter coming on to be heard upon motion of Henry L. Hess, United States Attorney for the District of Oregon, and Victor E. Harr, Assistant United States Attorney, for an order extending the time thirty (30) days from September 16, 1948, for filing the record on appeal and docketing the action, and the Court having considered said motion and the supporting affidavit filed therewith, and being advised, it is

Ordered that the appellant be and he is hereby granted an extension of thirty (30) days from September 16, 1948, within which to file and docket the record on appeal.

Dated at San Francisco, California, this 13th day of September, 1948.

/s/WILLIAM DENMAN,

Judge.

A True Copy. Attest: Sept. 13, 1948.

[Seal] /s/ PAUL P. O'BRIEN,

Clerk.

[Endorsed]: Filed September 13, 1948. Paul P. O'Brien, Clerk.

[Endorsed]: Filed October 19, 1948. [38]

[Title of U. S. Court of Appeals and Cause.]

MOTION

Comes now Henry L. Hess, United States Attorney for the District of Oregon, and Victor E.

Harr, Assistant United States Attorney, and based upon attached affidavit moves the Court for an order extending the time for filing the record on appeal and docketing the action, granting to appellant thirty (30) days from September 16, 1948. This motion is based upon Rule 73, Rules of Civil Procedure.

Dated at Portland, Oregon, this 10th day of September, 1948.

HENRY L. HESS,

United States Attorney for
the District of Oregon.

/s/ VICTOR E. HARR,

Assistant United States
Attorney. [39]

AFFIDAVIT

United States of America,
District of Oregon—ss.

I, Victor E. Harr, being first duly sworn, depose and say that I am Assistant United States Attorney for the District of Oregon; that I am one of the attorneys of record representing defendant in the case in the District Court of the United States for the District of Oregon, entitled, "Ross B. Hammond v. J. W. Maloney, Collector of Internal Revenue for the District of Oregon, Civil No. 3078"; that Notice of Appeal was duly filed in said cause on the 18th day of June, 1948; that upon motion of appellant the Circuit Court of Appeals granted an extension of ninety (90) days from the date of

filing of notice of appeal within which to file and docket the record on appeal; that the record in this case is quite voluminous, and the issues being complicated, the Solicitor General has not as yet determined whether or not this appeal will be prosecuted. This affidavit is made in support of a motion for extension of time within which to file the record and docket the appeal.

Dated at Portland, Oregon, this 10th day of September, 1948.

/s/ VICTOR E. HARR.

Subscribed and sworn to before me this 10th day of September, 1948.

[Seal] /s/ FLORENCE McKAY,
Notary Public for Oregon.

My Commission Expires: Sept. 4, 1951. [40]

[Title of U. S. Court of Appeals and Cause.]

ORDER

This matter coming on to be heard upon motion of Henry L. Hess, United States Attorney for the District of Oregon, and Victor E. Harr, Assistant United States Attorney, for an order extending the time thirty (30) days from October 16, 1948, for the filing of the record on appeal and docketing the action, and the Court having considered said motion and the supporting affidavit filed therewith, and being advised, it is

Ordered that the appellant be, and he is hereby granted an extension to October 23, 1948, within which to file and docket the record on appeal.

Dated at San Francisco, California, this 15th day of October, 1948.

WILLIAM DENMAN,
Chief Judge, U. S. Court of
Appeals, Ninth Circuit.

A True Copy Attest: Oct. 15, 1948.

[Seal] /s/ PAUL P. O'BRIEN, Clerk.

[Endorsed]: Filed October 15, 1948. Paul P. O'Brien, Clerk.

[Endorsed]: Filed October 19, 1948. [41]

In the District Court of the United States
For the District of Oregon

[Title of Cause.]

STATEMENT OF POINTS ON WHICH
DEFENDANT INTENDS TO RELY ON
APPEAL

The defendant having taken an appeal in the United States Circuit Court of Appeals for the Ninth Circuit, from a judgment rendered by the District Court for the District of Oregon, hereby designates the following points to be relied on in the prosecution of said appeal:

1. The District Court erred in finding and concluding that taxpayer's method of accounting clearly reflected taxable income.

2. The District Court erred in finding and concluding that taxpayer was entitled to deduct a percentage of his profits from the partnership

under profit-sharing agreements with two of his employees.

3. The District Court erred in denying defendant's motion to amend his answer and plead as a set-off that plaintiff had not overpaid his taxes on the grounds that he failed to include in his taxable income for the period involved all of his income from the partnership.

4. The District Court erred in finding and concluding that the Commissioner of Internal Revenue authorized the taxpayer to file his federal income tax returns on the accrual basis of accounting and in not concluding that the Commissioner of Internal Revenue authorized taxpayer to report his long-term contracts on the percentage of completion basis.

5. The District Court erred in not finding and concluding that taxpayer maintained stock piles of material which were not reflected in reporting net income from long-term contracts.

Dated this 19th day of October, 1948, at Portland, Oregon.

/s/ HENRY L. HESS,
United States Attorney.

/s/ VICTOR E. HARR,
Assistant U. S. Attorney. [42]

(Acknowledgment of Service.)

[Endorsed]: Filed October 19, 1948.

[43]

[Title of District Court and Cause.]

DESIGNATION OF CONTENTS OF RECORD
ON APPEAL

To: The Clerk of the District Court of the United States for the District of Oregon:

Defendant, J. W. Maloney, United States Collector of Internal Revenue for the District of Oregon, hereby designates that portion of the record in this case to be contained in the record on appeal, which is described as follows:

1. Complaint, filed March 16, 1946.
2. Answer, filed July 19, 1946.
3. Motion and Notice and Affidavit attached for leave to file an amended answer, filed October 17, 1947.
4. Objections to the Motion of defendant for leave to file an amended answer, and affidavit attached thereto, filed October 27, 1947.
5. Petition of the United States for leave to intervene, filed October 31, 1947.
6. Objections to petition for intervention, filed November 10, 1947.
7. Order sustaining plaintiff's objections to petition for intervention, entered and filed November 14, 1947.
8. Transcript of proceedings of the trial.
9. Findings of Fact and Conclusions of Law, filed April 21, 1948.
10. Judgment, entered and filed April 21, 1948.
11. Notice of Appeal, filed June 18, 1948.
12. Motion, Affidavit and Order of the Circuit Court of Appeals, granting extension of ninety

days from the date of filing Notice of Appeal to file and docket record on appeal, dated July 16, 1948, and filed July 22, 1948. [44]

13. Motion, Affidavit and Order of Circuit Court of Appeals granting extension of thirty days from September 16, 1948 within which to file and docket record on appeal, dated September 13, 1948, filed; October 19, 1948.

14. Order of the Circuit Court of Appeals granting extension to October 23, 1948, to file and docket record on appeal, dated October 15, 1948; filed, October 19, 1948.

15. Statement of Points on which Defendant Intends to Rely on Appeal.

16. Order to send trial exhibits.

17. This designation.

Dated at Portland, Oregon, this 19th day of October, 1948.

/s/ HENRY L. HESS,

United States Attorney.

/s/ VICTOR E. HARR,

Assistant U. S. Attorney.

/s/ THOMAS R. WINTER,

Special Assistant to the U. S.
Attorney.

(Acknowledgment of Service.)

[Endorsed]: Filed October 19, 1948.

[45]

In the District Court of the United States
For the District of Oregon

CLERK'S CERTIFICATE

United States of America,
District of Oregon—ss.

I, Lowell Mundorff, Clerk of the District Court of the United States for the District of Oregon, do hereby certify that the foregoing pages numbered from 1 to 48 inclusive constitute the transcript of record on appeal from a judgment of said court in a cause therein numbered Civil 3078, in which Ross B. Hammond is plaintiff and appellee, and J. W. Maloney, United States Collector of Internal Revenue for the District of Oregon is defendant and appellant; that the said transcript has been prepared by me in accordance with the designation of contents of the record on appeal filed by the appellant, and in accordance with the rules of court; that I have compared the foregoing transcript with the original record thereof and that it is a full, true and correct transcript of the record and proceedings had in said court in said cause, in accordance with the said designation as the same appears of record and on file at my office and in my custody.

I further certify that I have enclosed under separate cover copy of transcript of proceedings dated January 12-16, 1948, pages 1-501, inclusive, together with exhibits Nos. 1 to 20, 24, 26 to 32, 35 and 36, by direction of the United States Attorney.

In Testimony Whereof I have hereunto set my hand and affixed the seal of said court in Portland, in said District, this 20th day of October, 1948.

(Seal)

LOWELL MUNDORFF,
Clerk.

[48]

In the District Court of the United States
For the District of Oregon
Civil No. 3078

ROSS B. HAMMOND,

Plaintiff,

vs.

J. W. MALONEY, United States Collector of
Internal Revenue for the District of Oregon,
Defendant.

Portland, Oregon, January 12, 1948, a.m.

Before: Honorable Claude McColloch, Judge.

Appearances: Mr. Robert T. Jacob and Mr. S. J. Bischoff, Attorneys for Plaintiff, Mr. Thomas R. Winter, Special Assistant to the United States Attorney, Attorney for Defendant.

Court Reporter: Ira G. Holcomb.

PROCEEDINGS OF PRE-TRIAL
CONFERENCE AND TRIAL

Proceedings of Pre-trial Conference

The Court: You may proceed, Gentlemen.

Mr. Winter: My records show this case was coming on for pre-trial on the 14th. However, I

was down here on another matter. We would appreciate it if we could have one day intervening between the pre-trial and the trial.

The Court: When is the case set for trial? Tomorrow?

Mr. Bischoff: Tomorrow, your Honor.

Mr. Winter: I did not have any notice. I thought it was just the pre-trial on the 14th.

The Court: You have a case on Wednesday, Mr. Winter?

Mr. Winter: Yes, your Honor, and one on Thursday, I think, before Judge Fee.

The Court: I do not get you. You say you want a day—

Mr. Winter: Wednesday, I think, your Honor, it involves merely a motion for summary judgment. That is the case which was submitted to your Honor on pre-trial order without any testimony. I do not assume that will take more than a few minutes.

The Court: I would be glad to accommodate you if I could, if the calendar were not so involved.

Mr. Winter: I merely made that as a suggestion. I expect to spend two or three days here, or, at least, expected to spend two or three days in preparation for trial. I wrote to the Attorney-General and told him it was coming up on the 14th. [2] I was in court when your Honor set it, but I must have written down the wrong date.

The Court: Then we had better start in tomorrow in accordance with the setting. What is to be done this morning?

Mr. Bischoff: The pre-trial, your Honor.

Mr. Winter: At this time we are asking leave to file an amended answer on behalf of the defendant. We think we are entitled to set up an affirmative defense.

The Court: Is that something I have ruled on already?

Mr. Bischoff: Yes, your Honor.

The Court: All right. My ruling will be the same, unless you want to be heard again.

Mr. Winter: No. We think we can offer the evidence on the general denial. We deny that they reported the correct income, but we want to note an exception to your Honor's refusal to allow the defendant to file an amended answer.

The Court: Exception allowed.

Mr. Winter: Prior to pre-trial.

The Court: Yes.

Mr. Bischoff: There are two matters actually before your Honor. One is the pre-trial in the case of Hammond vs. Maloney and the other is a motion for summary judgment in the case of the United States vs. Hammond, Civil 3964, which was brought subsequent to your Honor's ruling on the motions that have been referred to, presenting, as we view it, the identical [3] issue of law which was already disposed of by your Honor.

Based upon that theory, that your Honor has disposed of the legal question that is controlling in that case, we have filed a motion for summary judgment in that case because in the Hammond case, if your Honor concludes we are entitled to recover, your Honor will be obliged to give the Government the relief which it is seeking by this

action, so, in reality, it may not be necessary to concern ourselves with considering that motion for the time being—that would be my view of it—until your Honor has heard this Hammond case and made some disposition of it. If we do not succeed, we are entitled to retain the money which the Government paid us; if we do succeed, your Honor will be obliged to give them the relief which they ask in that suit, so I can see no point in going into that matter at the present time.

The Court: Then go ahead with the main case.

Mr. Bischoff: This case, as your Honor already knows, is an action to recover a refund of taxes which the plaintiff paid upon the assessment of a deficiency in tax. The tax year involved is the year 1943, and for that year a deficiency in tax of something in excess of \$150,000 was assessed and paid.

We claim the assessment to be unlawful and that we are entitled to recover all the money paid, less the sum of about \$6500 which the Government refunded to us voluntarily and over our objection in arriving at its conclusion resulting [4] in a deficiency assessment.

This tax case is rather unique and interesting from this point of view—most interesting from what it is not rather than what it is. In this case we have no issue as to withholding from the taxpayer's reports or income tax returns of any income. It is not charged that we, either mistakenly or intentionally, withheld any income or failed to report any income that we should have reported. Neither is it a case in which it is claimed that the taxpayer deliberately or mistakenly padded

his deductions so as to minimize his tax liability.

In the last analysis, there is no issue of fact of any consequence that will be determined in this case, as we see the situation, viewed from the Revenue Agent's report out of which this case arises. The true issue will be legal, in my view. It will involve the question of the proper method of accounting. It will involve a sort of academic question in accounting which, in turn, will depend upon the legal interpretation of the meaning of the Revenue Act which provides for the manner in which a taxpayer shall account, that is, what method of accounting he shall employ, and that is, I think, in the last analysis, what your Honor will be called upon to determine.

What happened was this, briefly—and it may be profitable if your Honor will bear with me that I may make a little more extended statement of the situation, because ultimately we have to do that anyhow, either tomorrow or today, and [5] perhaps it would be just as well to do it today.

Ross B. Hammond is a contractor of many years standing in this community. He built this very courthouse and built many large structures in the Northwest. I think it is safe to say he built the largest and most important structures in this part of the country—a man of very high standing in the profession and in the community.

Prior to the tax year 1938, he conducted his contracting business through the medium of a corporation in which he was the largest if not the sole owner of the stock, and he kept his books—that is, the income from the corporate operations were reflected in the corporation's books.

He also, individually, during that period of time, had a few minor enterprises like farms or something or another, which did not amount to a great deal compared to the other operation, and in his personal income tax return he reported on a cash basis.

In 1937 that corporation had the contract for the construction of the State Capitol at Salem, which was being constructed by the corporation, and in that year the corporation kept its records and made its income tax return on what is known under the Revenue Act and regulations as the percentage-of-completion basis, and I will in a few moments explain that method in the technical sense.

But at the end of 1938 and before the Capitol was [6] entirely completed, the corporation was dissolved and the contract was completed in the following year, or substantially completed, except for one and seven-tenths per cent in 1938—was completed by Hammond individually and, for the purpose of being consistent with the method of accounting for this project, he continued to keep the records in connection with that construction job on the percentage-of-completion basis in 1938, and made his income tax return on that basis, so as to have a consistent accounting method to arrive at the profit for that particular contract.

However, anticipating a change in his operations with respect to subsequent contracts, he made application to the Commissioner of Internal Revenue in 1938 for permission to change his individual method of accounting and reporting his income from the cash basis, upon which he had been

theretofore, to the accrual method which he wanted to adopt, and the Commissioner granted that permission to him to adopt the accrual method, beginning with January of 1938.

Your Honor will have to bear in mind what I said before that in 1938 he individually completed that contract and had reported the income on the percentage-of-completion basis, which did not conform to the permission granted to adopt the accrual method, but he was advised that for that particular unfinished contract, in order to clearly reflect the income, he had to report the balance of the contract on the same basis [7] as he had reported prior thereto; otherwise he would have a distorted income basis, and it is generally recognized in accounting that you have to have a consistent basis throughout in order to clearly reflect income—you could not have part of your report on one basis and part on another.

But beginning with the year 1939, from January, 1939, when the Capitol contract was completed, except for this one and seven-tenths per cent, he adopted the accrual method of accounting; his account books were set up on that basis with all of the accounts which are needed to reflect such a method, and consistently carried that method of accounting right on down to the present time, in fact, and including the tax years with which we will be concerned. He made his income tax return upon the accrual method of accounting.

He did that for the year 1939; he did that for the year 1940; he did that for the years 1941,

1942, 1943 and 1944. In our trial we are going to be concerned with the figures that were involved in 1941, 1942 and 1943, and perhaps to some extent with 1944, but from 1939 on there was that consistent practice.

After those returns were filed for the years mentioned, 1939 on down, the Internal Revenue Bureau audited those returns. The return for the tax year 1939 was audited twice and two separate reports were made, and of course it was then known that we were on an accrual basis. They rendered two Revenue Agent's reports which resulted in an over-assessment of some [8] small amount; they claimed he had overpaid some small amount and that amount was refunded to us. No question was raised as to the method of accounting, either that we had the right to use it or that it was accurately kept, except for a minor mistake which resulted in this small refund paid us.

The return for 1940 was audited twice by the Internal Revenue Bureau and two separate Revenue Agent's reports were made that adopted our accrual method of accounting, did not question it, and did not question the accuracy; and in that year again they found an overpayment of about \$160 and refunded it to us.

They audited the return for 1940 and the audit in that year, significantly enough, was made in 1943, the year in which the forgiveness tax act was in effect. They did not question that return on the basis that we had no right to use the accrual method of accounting or, having used the

accrual method, that we had not accurately carried it out. The result of the audit was merely to disclose a deficiency in tax to the extent of some \$200, resulting from some error, not because of the method employed. They did not say we did not have the right to use the accrual method or that the method was not properly carried out, but there was some technical error which resulted in a deficiency, and we paid it.

They audited the return for the year 1941, and that is a highly important year to bear in mind, because they now [9] seek to upset that return, and they seek to upset their own report for that year—

The Court: You are going into another matter now. I want to talk to these other lawyers for a moment.

(The Court then proceeded to the transaction of other business.)

Mr. Bischoff: The return for 1941 was audited in 1943 when the forgiveness act was in effect. The Revenue Agent's report did not there challenge the right to adopt and use the accrual method of accounting, nor to report the income upon that basis, nor did they challenge the accuracy of the return or the manner in which the accounts were kept. The audit resulted only in the determination of a deficiency to the extent of \$278.94, again arising from some erroneous treatment of an individual item, which did not arise from the basic controversy that we have here as to the method of accounting employed and whether or not we

had a right to use that method of accounting. We paid that deficiency as determined, because it was recognized that there was an error in that respect.

At this point, before I go on with subsequent years, I should point out to your Honor that this method of accounting that was adopted and was set in motion in the beginning of 1939 was not and could not have been in anticipation of any such question as arises now in this case; that is, the application and treatment of the forgiveness act which was passed in 1943. [10]

Prior to that time every inclination on the part of any taxpayer would have been to keep his income down for the particular year, rather than the reverse, but certainly it could not have been because there was no such law in existence, and that was unknown. When they set up the books on the accrual method, beginning in 1939, and consistently thereafter, they did not wait until the end of the year to determine whether the income should be accrued in that year or whether it would have been profitable, taxwise, to accrue it in subsequent years, which might have been done, if they had postponed the determination of that question to the end of the year.

In this case, every month, as the income accrued, it was entered on the books and every month's liabilities that were incurred for expenses were entered upon the books and, at the end of the year, the only thing that was carried was the cumulative amount of both of these accounts in

final closing entries, so it could not be suggested here—and, indeed, no contention was made that there was any element of bad faith in the adoption of that method or the manner in which it was carried out. It was an attempt to set up a method, the adoption of an accrual method, which the courts have said is the most scientific and accurate method of reporting income, and that method was consistently and continuously followed out through the years.

In the year 1942 the return was not audited separately. It was audited in the Revenue Agent's report issued in 1944, [11] November 6, 1944, and at that time they re-audited the 1941 return which I just called to your Honor's attention. They audited the 1942 return; they audited the 1943 and the 1944 returns, with the result that two Revenue Agent's reports were rendered, one by which they found, for the first time, or determined for the first time, that our method of accounting on the accrual basis was not permissible; that we had no right to use the method and, therefore, we had, strangely enough, overpaid — we had reported more income in 1941 than we should have and, as a result, the Revenue Agent reported that we had paid \$6500 in taxes more than we should have paid upon the system of accounting which he substituted for the manner that we had reported on.

That was made the basis of a separate Revenue Agent's report, but it is dated the same date as the report which dealt with the years 1942, 1943

and part of 1944, and, apparently, was, we think, contemporaneous. I do not believe there will be any question as to that.

When he found that they had reported too much income in 1944, he threw that excess into 1942. I beg your pardon. When he found that they over-reported their income in 1941, he threw that excess into the year 1942, increasing our income for that year by that amount.

When he examined the 1942 and 1943 returns, which are virtually one return—involve the intervention of the forgiveness [12] act—he determined that a large amount of income reported in 1943 was improperly reported as income for that year and he threw that back into 1942.

In other words, he did both—threw 1941 into 1942, and 1943 into 1942—and, by that means, swelled the amount of income for the year 1942 and diminished the income for the year 1943, with the result that the higher bracket and rate were made applicable to the year 1942, for one thing, but the important thing was that, having diminished the income in 1943, the amount of credit which the forgiveness act entitled to was reduced.

As your Honor will recall, the forgiveness act, passed in 1943, gave a taxpayer the right to deduct 75 per cent of the tax due in either of the two years, whichever was the lower, so the Revenue Agent creates the year 1943 as the lower year and deprives us of 75 per cent credit or the 75 per cent that we would have been entitled to pay upon the income as reported. By that means he

created a deficiency in tax for that year amounting to \$150,000, odd.

That is the procedure and technique by which that was accomplished, and it is our contention here that this method of accounting would never have been challenged, and it was not challenged except for the intervention of the forgiveness act, and this method which the Revenue Agent adopted and upon the Commissioner based his assessment, either intentionally [13] or at least in the legal result, deprived us of the benefits of the consideration which the Congress gave to every taxpayer in that period of time.

The Court: What is the law, pro and con?

Mr. Bischoff: I am just about to come to that, your Honor. Before giving your Honor our views on the law upon that question, I want to point out that when the Revenue Agent re-audited these returns for the years 1941, 1942 and 1943, he did not reject the amounts of income which we reported in these several years; he did not question them; and, in fact, he adopted them. For example, we reported—and your Honor will have these exhibits before you in due time. For instance, we reported on a given job, like the Milwaukie Housing Project, that we got \$36,547.78 in 1941 and \$245,018.89 in 1942, and so on down the line.

Those figures were not challenged, and the Revenue Agent adopted those figures in arriving at the basis of computation that he subsequently adopted—on the computation that he subsequently adopted he applied a percentage basis, which is what he claims to have done to these very figures.

The law, your Honor, in our view with respect to this matter, is this: The Internal Revenue Code gives to the taxpayer the absolute right, the unqualified right, to choose the method of accounting, with this proviso, that the method employed clearly reflects income. That is the phrase that your [14] Honor is going to have to construe here, "clearly reflects income", and let me point out that it does not say "clearly reflects income in a given year", but it merely says "clearly reflects income", and that is going to be significant as I will presently point out.

Provision is made in the Act that if the method employed does not clearly reflect income, the Commissioner of Internal Revenue may re-compute the income. The law in that respect is that when he does determine that the method employed by the taxpayer does not clearly reflect income he must adopt a method of computation; that is, the Commissioner must adopt a method of computation which is recognized by the Internal Revenue Act and by accounting practices. He cannot adopt a hybrid system. That is, he may adopt a cash method or an accrual method or a percentage-of-completion method or a completed-contract method, but he cannot create a method of his own which is part one and part the other.

I have pointed out to your Honor that there were four methods of accounting. Let me first state very briefly—your Honor undoubtedly knows in a general way what was required. There is the cash method which, in simple terms, merely means that

the taxpayer must report his income as income—must report what he has received. He cannot report income that he has not received, no matter what the reason might be, except in rare cases of what is called constructive receipt as, for example, [15] where a taxpayer has a right to receive it but deliberately refuses to take it. For example, somebody tenders him a check on December 31st in payment of a bill and he wishes not to accept it until January 1st. The courts treat that as a constructive receipt but, barring things of that kind which are affected by good faith, on the cash basis he must report only actual receipts and, for his deductions, he can take only actual payments regardless of any liability involved. That is the standard for cash basis accounting.

Under the accrual system, the reverse is true. The receipt of revenue as income, in fact, plays no part. It is the time when his right to receive payment accrues, as, for example, a merchant had sold a bill of goods on December 1st and he has issued an invoice for it. The right to receive that has accrued as an account receivable and he must throw that in, in that year, as revenue, even though it is paid in a subsequent year and even though it may never be paid by reason of the insolvency of the debtor.

With respect to his deductions, he is permitted and, in fact, is compelled to report all the indebtedness that he has incurred. Whenever he has any liability to pay a bill of merchandise or labor or material, whatever the case may be, he must treat

it in that year as a deduction, regardless of when he pays that bill. The essentials are the right to receive that revenue and the obligation to pay for liabilities [16] incurred. That is the standard for the accrual basis. The authorities which we will give your Honor will fully support what I am now saying about this.

The regulations set up two permissible methods of accounting which relate to a contracting business. The Regulations permit him the right, but do not make it compulsory, to adopt one of two methods, the percentage-of-completion or a completed-contract basis.

Take the latter first, the completed-contract basis: Under that system, when a contract extends over a period of more than one year, the contractor can defer the reporting of income and deductions until the final completion of the contract. In other words, in the first year of his operation, if a contract is not completed, he need not report receipts or expenditures, but he is required to make a complete report of the operation after his revenues and expenditures have been determined, and his profit is thereby determined. That is the completion method of accounting.

The percentage-of-completion, roughly speaking, requires that a contractor estimate the profit that he will make on a contract and, bear in mind, he must estimate if he cannot determine it for a certainty—he is required to estimate the amount of profit he holds or expects to make from a given contract. Against that he places the contract price

of the job and, by that method, he determines the percentage of profit that [17] he hopes to make on the contract. With the percentage established by this estimating method, he then, at the end of a given tax year, when the contract is not completed, determines the percentage of completion of the contract. That is to say, he would have to determine, by some recognized method, the percentage of completion of a contract as a whole, that is, the whole structure, for example, how much of the steel work was completed and how much of the cement work was completed, and how much of this and so on. It requires a determination of the percentage of completion of a building, for instance, and that fixes the ratio of profit, and that profit can be reflected, naturally, in the proportion that the percentage of profit bears to the part constructed. That is, roughly speaking, the formula which permits that method to be employed, and when it is adopted by a contractor he must adopt the formula which is laid down for him, and I want to read that to your Honor because it is going to have a very important bearing upon this case.

I am now reading from Regulation 101 in effect under the Revenue Act of 1938 and will presently read to your Honor from the subsequent regulations. That regulation is No. 42-3(a), and it says "Gross income derived from such contracts may be reported upon the basis of percentage of completion." The courts have held that was merely permissive and not compulsory.

“In such cases there should accompany the return certificates of architects or engineers showing the percentage of [18] completion during the taxable year of the entire work to be performed under the contract. There should be deducted from such gross all expenditures made during the taxable year on account of the contract, account being taken of the material and supplies on hand at the beginning of the taxable period for use in connection with the work under the contract but not yet so supplied.”

There is the ritual which the Commissioner sets out for anyone who wants to avail himself of the option to adopt the percentage - of - completion method of accounting, but we concede we did not follow that ritual from 1939 on down because we had not adopted that method. We were on the accrual method and, therefore, were not obliged to follow this ritual, but here is a very significant provision in that regulation: “If, upon completion of a contract, it is found that the taxable net income arising thereunder has not been clearly reflected for any year or years, the Commissioner may permit or require an amended return.”

Under that provision should it develop that the income as reported did not clearly reflect the income for the year or years involved, then the contractor will re-audit the entire business and arrive at the true income. That provision was eliminated from the regulations. It is not to be found in the regulations which became applicable to the years beginning December 31, 1941.

The ritual for keeping the account is exactly the [19] same but that is just the part which permitted the use of the information obtained upon completion of the contract for the purpose of revising the figures, but that part was eliminated. It was the only instance in the Revenue Act where such information was permitted to be used for the purpose of revising an earlier return, but it was eliminated.

The reason I emphasize these things is this, that when the Revenue Agent came to the conclusion, for reasons which we will presently point out, that we had no right to use the accrual method of accounting—and then, in an alternative determination, if we did have the right to use it, it was not adequate and did not clearly reflect the income—he set about to adopt a method of his own posthumously in 1944; he set out to adopt a method of his own for redetermining the income for 1941, 1942, 1943 and 1944, and, when he did that, he adopted a hybrid method of accounting, for one purpose, namely, to determine the amount of income on the basis of the amount of completion, the percentage, which he ascertained, he adopted the figures on income as we set them out in our accounting method and in our return. He did not question them. He adopted them and used them, so he took, in part, at least, the accrual method which we used, and he says in his report that we did use the accrual method.

He then, for the purpose of determining the percentage of profit to be applied, adopted the

completed-contract method. [20] He looks to the ultimate result as it was ascertained in 1944 and he determines that we made so much profit from each of these contracts. At that time it was a known fact, had become a known fact. He used that basis for the purpose of determining what our profit from these contracts was. When he did that, he did the very thing which was eliminated, which might have been permissible under Regulation 101, but which was no longer permissible, when he attempted to adopt that theory; in other words, to take the completion of contract information and use that for the purpose of determining the basis for the purpose of determining the percentage of profit.

Then he adopted a third method. He introduced and used in connection with that a third method, namely, the percentage-of-completion method by which he determines the amount of profit as related to the percentage of completion of the contract. So, we have this hybrid system of accounting by which he arrives at his determination in this case, which was not only prohibited by the Revenue Act in the elimination of this regulation, but decisions which we will call to your Honor's attention equally frowned upon it and prohibited it and condemned it.

Now, we say that was an arbitrary method employed, one that did not have any justification in law or in fact and, being arbitrary, whatever presumption of correctness there attaches to a Commissioner's report immediately falls, when it

[21] becomes apparent to the Court that an unjustified method was employed; that presumption of correctness then falls, and there is nothing upon which to justify the assessment as made, and it becomes an unlawful assessment.

The Court: When did he pay the money?

Mr. Bischoff: The money was paid in 1945, after the Revenue Agent's reports were made. As I have pointed out, the tax was assessed and we paid it. When we received a refund of \$6500, we were required to file a claim, but in that claim we made the specific provision that it was being done under compulsion. The language of it will be before your Honor.

Your Honor will recall in the case of the United States Supreme Court laid down the doctrine that, when it becomes apparent to the Court that a method or system was employed by the Commissioner in determining a deficiency which had no legal foundation in law or in fact, the deficiency assessed upon it must fall; it is not necessary then for the taxpayer to go on and establish what the deficiency ought to be, or that it ought to be something else.

The Court: When did you sue?

Mr. Bischoff: I beg your Honor's pardon?

The Court: When did you sue?

Mr. Bischoff: We sued in 1946, in early 1946, your Honor. This case has been pending a long time. We sued shortly after payment was made.

The Court: Was there an offer to compromise?

Mr. Bischoff: One of the reasons for the long

time in the case coming to trial is that there were negotiations for compromise, which did not materialize, although they thought they would come to an understanding.

As I stated to your Honor earlier, the crucial question you will have to decide is the meaning of this term "clearly reflect the income." When your Honor reads the Revenue Agent's report, you will see that he construed that language to mean that the accounting method must clearly reflect the income for any given year. In other words, one year needs in itself to be taken out by itself. You will see that he construed that to mean that the accounting method had to clearly reflect the income in that one year, and his whole criticism of our accounting method is predicated, in large measure, if not almost entirely, upon the proposition that the method we employed does not clearly reflect the income.

The Court: Why was it necessary for you in the beginning to ask for permission to change your method?

Mr. Bischoff: The statute requires permission. If your Honor will recall, Mr. Hammond, individually, not the corporation, was on a cash basis prior to 1938. When he dissolved the corporation and was going to continue the contracting business in his own name, he wanted to be on the accrual method. I will comment on that in a minute. [23]

Since he was himself on a cash basis, he was not permitted to make the change to an accrual basis without obtaining permission from the Com-

missioner. That is the regulation, and, so, pursuant to that, he applied for permission and got it.

One of the reasons why it was claimed we were not authorized to use the accrual method is that in 1938 he had reported the balance of the State Capitol contract on the percentage-of-completion basis. He was performing that contract individually, not as a corporation.

Having reported in 1938 on that basis, they say that we were compelled, therefore, to continue on that basis and that we could not change it, but we did have permission of the Commissioner to change it.

What actually happened was that, while we had permission to use the accrual method in 1938, the return was made—so it is claimed here—on the percentage-of-completion basis to be consistent with the first part of the contract, because we could not report a part of the contract on one basis and the balance of the contract on the other. We are required to be consistent, but our contention is in that respect that, even if there had been a deliberate violation of that permission in 1938, which was to use the accrual method in reporting the balance—that using the percentage-of-completion method, as we did, instead of the accrual method, which we were permitted [24] to use, assuming that we either mistakenly did so or even intentionally did so, that would not preclude us from obeying the law thereafter, beginning with 1939, because the only permission we ever had was to go on the accrual basis so, in 1938, assuming that the method

of reporting income for that year was not the accrual method, on the accrual method, we certainly were legally obligated to pursue the legal method, the legal method being the method which the Commissioner permitted us to use and, having permitted us to use the accrual method, we could not use any other. Upon that narrow ground that, because we violated the law in 1938, we should have continued to violate the law continuously thereafter—

The Court: How did you happen to violate it in 1938?

Mr. Bischoff: I have tried to explain that. We do not say it was a violation. I was just using that term hypothetically. Your Honor will recall in 1938 the only contract being performed was the State Capitol. It was the completion of a contract begun by the corporation in the preceding year. In the preceding year the corporation had reported upon a percentage-of-completion basis so, when the balance of the contract had to be reported, they were in a quandry. Should they report the income on the percentage-of-completion basis to be consistent or should they adopt the accrual method, which would have been inconsistent?

They took counsel, and they were advised they would have to be consistent because they could not reflect the true [25] income with respect to the contract otherwise. Even under the most extreme view, if we had violated the law in that respect, that year, or had mistakenly used that system in that year, we would not be legally bound

to continue a mistake or a law violation thereafter. That is our view about that particular phase of it.

They go on to say that, assuming we did have permission, we did not carry our accounting on an accrual basis, an actual accrual basis and, frankly, your Honor, I have not been able to ascertain from the Revenue Agent's report why that method was not an accrual method. Perhaps a statement from counsel here will enlighten us and clarify that issue. We have the books in court and the accountants who kept them and the accountants who examined them and they will testify that the accrual system was adopted and carried out in every respect.

In that same connection, I should point out to your Honor that, when the decisions speak of the adoption of a method, generally the method is that errors that occur in the normal carrying on of accounting do not determine that the method is improper or that the method was improperly adopted or used. Errors are adjusted. If, for example, an item of several thousand dollars was erroneously accrued in one year and should have been accrued in a subsequent year, that can be adjusted, but it does not change or affect the method.

In a very recent case, which I think will be controlling [26] in this case, the case of Security Flouring Mills Company against the Commissioner, the Supreme Court opinion set at rest, once and for all, all controversy as to the meaning of this

term "clearly reflect the income", and they said, in unmistakable terms, that it does not mean that it must "clearly reflect the income" in a given year, but it must clearly reflect the income over the period of years during which a contract is being performed.

The Supreme Court also points out that both the cash and accrual methods have certain deficiencies, because they said in every business enterprise it happens at the end of a year that certain moneys that should have been received had not been received, or, in some years, some accounts that should have been accrued have not been accrued. There is always a hangover by reason of certain bills not having been received, or whatever the case may be and, as a result, certain matters are carried over from one year into the other, whatever system is employed and errors resulting from that condition do not mitigate against the adoption of one or the other method. Whatever errors may creep into accounting, through human frailty, are subject to adjustment.

The Court: Shall I hear from Mr. Winter now?

Mr. Bischoff: I think I have about stated our position.

Mr. Winter: There is one further issue.

Mr. Bischoff: I am sorry. There is one other issue in [27] the case which is unrelated to the method of accounting, and that is whether a partnership existed in the two years under consideration, in 1942 and 1943, between Ross B. Hammond,

the plaintiff, and his son, William A. Hammond. A definite issue is raised as to that, and it is claimed that there was no partnership in reality, although there was a partnership agreement.

With respect to that particular issue, they point out that there was absent all the usual indicia of partnership; for example, the partnership is not disclosed to those persons to whom the existence of a partnership would normally be disclosed, as, for example, the banker, the business associates, that is, some men that they had on a profit-sharing basis, and it was not disclosed to the bonding company, and the contracts were taken in the name of Ross B. Hammond, individually.

A great many circumstances of that kind are pointed out in the Revenue Agent's report which, it is claimed, shows that there was no partnership in fact in existence, notwithstanding the fact there was a written partnership agreement.

There is but one answer to all of the criticism of that partnership, and that is this: The intention of Mr. Ross B. Hammond and his son, William A. Hammond, to enter into partnership in the construction business was present for many years; from the earliest time that the boy was going to school it was contemplated that he was to become interested with his father [28] in the contracting business, as a partner. His education was channeled in that direction, by his training as an engineer, and everything else was directed to that end. It had been the subject of family discussions for years, but when it came time to actually

put that arrangement into operation Ross B. Hammond found himself in a very embarrassing situation.

Ross B. Hammond had at the time—and this was in 1942, in the middle of the war, when important help was hard to get. He had in his employ two men, Petersen and Mason, who had been with him for many years. They had grown up in the contracting business and had become his right and left arms and hands. They were the men who carried on the physical construction of buildings for him, became invaluable to him, and unreplaceable at that time and even at other times.

These two men were clamoring for a partnership. He did not want to make them partners for reasons of his own. He was not averse to giving them adequate profit-sharing agreements but he did not want to make them partners, preferring that whatever business he had should remain in the family and, so, when the conclusion was reached to make the boy a partner, there were these two men. He had to tell them that he did not want to have any partners but wanted to be a lone operator; on the other hand, he wanted his son in partnership with him, so he had to keep secret from these two men the partnership agreement.

The partnership agreement with his son was made on [29] the same date as the written profit-sharing agreements were entered into with these two men. These two men had had very large responsibilities there which enabled them to know all of

the details of the business. They signed checks; they negotiated purchases and sales and did many of the things that Mr. Hammond did himself, and it was necessary for him to conceal from them—not only not to tell them he was taking the son into partnership but he had to conceal from them the sources of information that they might have access to.

It happened that the father-in-law of one of these men, Mr. Mason, was an officer in a bank with which Ross B. Hammond did business, and he knew that if he made a change in the bank account that information would immediately be communicated to Mason and he would become aware of it and there would be trouble.

Then there were other problems that intervened. We were at war. It was necessary to do things in a hurry. Part of that time Bill Hammond was in the Army; part of the time he was out of the Army. There was a question of his eligibility and his physical disability and, in making contracts and carrying out large orders where there were various papers that had to be signed, if Bill Hammond was a member of the partnership and the contract had been taken in the name of the partnership, it would have been necessary to have the son's signature to all of those papers. Practically all of the contracts were with [30] the Government. It would have been impossible to get his signature on some papers and there would be delays, interminable delays. Then there was the question of obtaining bonds, the very lifeblood of a contractor.

The lifeblood of a contractor is ability to obtain bonds for his contracts. He had to maintain that relationship with the bonding company. He was advised by a representative of the bonding company with whom he did business that it would not be desirable, because of Bill's military obligations, for him to be a member of the partnership, because he would have to sign contracts, he would have to sign bonds, he would have to sign documents relating to contracts, if there were cancellations or modifications and what not.

Therefore, to avoid these complications during the war, the existence of the partnership was kept secret, but, as between themselves, they had a written contract, and they made their adjustments on a partnership basis. Securities, however, were purchased in the name of Ross B. Hammond, but they were discussed between them, and, in every sense, as between them, they had a true and bona fide partnership. Ultimately the information was divulged to Mason and Petersen and the need for secrecy was eliminated, especially after Bill was finally discharged from the Army by reason of disability, and then, of course, the partnership was made known and an assumed name certificate was filed.

The law, as we know, has recognized secret partners. [31] There are many instances in which men with capital want to make investments in a partnership but, for reasons of their own, require their identity to be unknown. Simply because they keep that partnership agreement secret between themselves would not affect their legal relation-

ship or prevent a partnership liability to accrue as against a secret partner.

For example, if the Government would seek to enforce a tax liability, they would not have hesitated to proceed against William Hammond as a partner, notwithstanding the fact that the partnership had been kept a secret during that time. They would have asserted their liability, whether the partnership was secret or open.

We can realize, of course, that in a normal case there are certain pertinent circumstances which militate against a secret partnership, but where there is reason for that secrecy and where it is in good faith, then your Honor will have to conclude that the absence of an acknowledged partnership is not significant and will not militate against the existence of a partnership.

Mr. Winter: Turning to the second issue first, it is true, as counsel has suggested, that this was to be a most secret partnership. As a matter of fact, it was not until 1944 that any partnership returns were made. The partnership was even unknown to the accountant and bookkeeper for Mr. Hammond.

On the same date that this alleged partnership agreement [32] was entered into, the son, just recently back, executed a power of attorney to his father. The partnership agreement speaks of \$7500, which was the salary paid to him prior to the formation of the partnership.

It is our position, of course, that the son did not contribute any more service or contribute any

more than the salary which he was to be paid, \$7500; that there was no consideration for the partnership agreement other than a gift from the father, and it is our position that the partnership was invalid, so far as income tax purposes are concerned.

With respect to the first issue: This is not the first time Mr. Hammond or his corporation has had difficulty or been before the Court with respect to this accounting practice.

Prior to December 30, 1937, Mr. Hammond operated in the form of a corporation. Prior to 1933 the corporation kept its books and reported its income upon the completed-contract basis. In other words, they waited until the end of the contract had been completed, and the profit was then reported. Without securing the consent or permission of the Commissioner, after 1933 they reported and prepared the returns on the percentage-of-completion basis. The Commissioner denied them the right to so report, not having secured the prior permission and consent, and he went to the United States Tax Court, then the Board of Tax Appeals, and they said he could not change the [33] basis.

As of December 31, 1938, the Commissioner did authorize Mr. Hammond to report his tax on an accrual basis. When the matter was investigated by the Internal Revenue Department, while the books were purportedly kept on an accrual basis, nevertheless the contracts and returns were on a percentage-of-completion basis, or a hybrid basis. It was not an accrual basis nor was it a true percentage-of-completion basis.

For example, if the Court please, there was no inventory or no consideration, as required by the Regulations, given to work which had not been completed but was in process as of the end of the year, nor to equipment or material which had been accrued on the books.

Because their accounts did not clearly reflect the income, it was necessary for the Commissioner to "recap" or readjust the report so that it did clearly reflect the income for the particular year.

For example, the taxpayer had a contract for the Troutdale Aluminum Plant, what is known as Contract No. 208. In 1941, the taxpayer reported income received of some \$59,000 and showed a profit of \$23,844.25; in other words, almost 50 per cent profit in that one year on that contract. Coming to the next year, although the taxpayer shows income received of \$1,036,522.10, he shows a loss of \$20,786.73, so the only supposition is, if the Court please, that during the year 1942 [34] there must have been a great deal of uncompleted work for which they could not bill the Government in connection with that contract.

Taking the next year, 1943, instead of \$1,000,000 income, they show \$274,431.59 and they show a profit as per their books of \$93,936.62.

No inventory was taken as to how much material was on hand on any particular job at the end of the year, and the regulations specifically say that must be taken into consideration. It clearly appears that the method of accounting and the returns did not clearly reflect the income and the Commissioner

is authorized, by the statute and regulations, to adopt a method which, in his opinion, more clearly reflects the income.

The burden is upon the plaintiff to show that his books and records and returns clearly reflect the income.

The accounts in connection with the Troutdale Aluminum Plant present the most glaring example of distortion of income. All the rest of them show substantially the same but not in quite as large a percentage. No consideration was given to any materials which had been ordered and which were on the job at the end of the year. There is no way for us to go back six or seven years, now, and show what amount of materials was on hand or what percentage of the contracts was completed on a given date.

There is one other matter, your Honor. There is no [35] issue as to the gross receipts from all of these construction contracts. We do deny the plaintiff has reported his full income, what he has accrued. The burden is upon him, however, to show that he has overpaid the tax and that he has taken proper deductions and credits. The record will show that in arriving at the partnership income there was deducted, as an accrual, some \$86,635 in 1942 and \$77,360.30 for the year 1943. That arises under these facts, if the Court please:

Mr. Mason and Mr. Petersen, plaintiff's employees, were key employees and Mr. Hammond's managers of his construction contracts. They did not know about the partnership agreement. They

have agreements with Ross B. Hammond, doing business as Ross B. Hammond Co., and not with the partnership, although the agreement is purported to have been executed on the same date as the partnership agreement with the boy. Yet, it makes no reference to the partnership and, as explained by counsel, it was intended that no one would know about the partnership except Mr. Hammond and his son.

Under these agreements, Mr. Hammond, as sole proprietor, agreed: "The first party hereby agrees that he will pay for the services of the second party by permitting him to participate in the net profits of the operation of first party's construction business upon the basis of fifteen per cent of the profits earned each calendar year, after all operating, financing, administrative, and other like expenses [36] have been deducted, but before deduction of State and Federal income taxes."

Petersen was permitted to draw only \$7500, which was his usual salary. The other man, Mason, had \$10,000. However, under the agreements they were required to leave the balance in the business, and only in the event that they left the employ, and under certain terms and conditions, could they ever withdraw this profit, which was going into the business. In other words, it is our position that at no time did they have the right to receive payment of that money and, therefore, it was not properly accrued as an item of expense on the books and, therefore, that is additional income. I believe the burden is on the plaintiff to show that

he did not receive that additional income. Otherwise plaintiff is not entitled to recover in this case. I think that explains our position on that, if the Court please.

Mr. Bischoff: May I make one or two observations with respect to the matter now suggested so that your Honor will know our views?

First, let me state to your Honor that I do not quite understand the reference to Mr. Hammond's prior tax troubles. Counsel knows that the only sin Mr. Hammond was guilty of in that case was the technical one of not having obtained permission from the Commissioner to change the method of accounting. They were going to make a change in the method of accounting and they felt they had a right to do that without having permission. [37] It was not determined that he was actually guilty of any wrongdoing. In fact, at that time it was a question of a bad method of accounting, because we did not know the requirements, that permission had to be obtained. They were saddled with a tax liability and that was the sin committed, and that was the tax trouble that counsel wants your Honor to have in mind so your Honor would be prejudiced against Mr. Hammond by reason of this prior tax trouble.

We tried to avoid that sin in this case, because when we made the change-over, dissolving the corporation, and Mr. Hammond went on a cash basis; and he wanted to go on an accrual basis, and we applied for permission and got it. That was the sin involved.

With respect to the charge that is now made, and that is not set forth in the Revenue Agent's report, that we understated our income by reason of the credit which was given to the profit-sharing agreements to Mason and Petersen: He tells us that in those two years we accrued that, not as income but as a deduction. He says we understated our income. There is no question of income involved. We took as a deduction the share of the profits which these two men became entitled to under their agreements. It was only accrued on our books. Nevertheless, we had to credit Mason and Petersen with that profit in those years because, under our contracts with them, we had to determine their profit on the same basis as Mr. Hammond [38] kept his books so, having become liable to them by virtue of the contracts for the share of profit to be determined according to how these books were kept, having become liable, it became a deduction; we were compelled to accrue it in that year. So far as deductions are concerned, it is an obligation to pay, and if we had not accrued those two items in those two years, we would forever have been barred from getting the benefit of that deduction.

The Court: Did you pay those amounts?

Mr. Bischoff: One man has been paid in full and one man has been paid off partially, almost in full.

Mr. Winter: Was that in stock of the corporation?

Mr. Bischoff: No, in money, in hard cash.

Mr. Winter: They do not report it here.

Mr. Bischoff: They were not obliged to report it last year, because these men were not on the accrual basis. They were on a cash basis. They reported it when they got it, but we were compelled to report it as a deduction in the year when we became obligated for it.

Counsel mentioned something about failure to keep an account of materials on hand and of expenditures made during a given year. Under the accrual method, your Honor, that would have nothing to do with the reporting of profit and the question of loss in a given year, because it is only the right to receive that accrues income to us—not when we received it. [39]

We may spend, in a given year, \$100,000 towards the performance of a contract but if, under the contract, we are not entitled to receive payment of that \$100,000, by reason of some contractual provision which defers payment to some other time, the liability has accrued then, **your Honor**. We have got to report it under the decisions and under the Act in the year in which it became an account receivable and billed as such.

Your Honor is familiar with Government contracts and with the fact that they contain a provision for monthly estimates; they contain extensive provisions as to how the monthly estimates are to be arrived at. They have to be certified by the engineer.

When that is done, our right to receive that payment has accrued, regardless of when the Gov-

ernment sees fit to pay us. Sometimes the Government pays very soon after the monthly estimates are made and sometimes, because of the red tape in governmental operation, it takes three months or more to get a payment, but the right to receive the payment accrued under the contract when the engineer approved the monthly estimate. That is why we had to set it up on the books on the accrual system. We could not do it in any other way, so it does not make any difference whether we had any materials. We had to take the deduction in the year in which the liability arose.

Of course, it does unbalance the income in any given year, as the courts point out, but in the end the situation [40] rights itself because, if he takes a deduction for \$100,000 worth of material in the year in which he incurred the liability, he cannot take it in the subsequent year when he actually pays it. On the other hand, if he accrues an account receivable as income in a year when he did not get the money, he cannot take it as income the next year when he actually did receive the money. As the courts point out, including the Supreme Court of the United States, these methods equalize themselves.

Counsel lays some stress upon the failure to keep an account of the inventory and work in progress. He says the regulations require it. I challenge him to submit to your Honor any regulation requiring such accounting under the accrual system pertaining to contract work.

There is a regulation that deals with that, and

that will be called to your Honor's attention. I will call it to your Honor's attention now.

Section 41-3 deals specifically with accounting methods to be employed where the purchase and sale of material is a profit-producing factor, like from merchandising, a grocery store, for instance, to the manufacture of lumber and so forth. Here is what it says:

"In all cases in which the production, purchase or sale of merchandise of any kind is an income-producing factor, inventories of the merchandise on hand (including finished goods, work in process, raw materials and supplies) should be [41] taken at the beginning and end of the year and used in computing the net income of the year."

There is the regulation and, by its very terms, is limited to that kind of taxpayer, namely, one who is buying and selling merchandise, manufacturing merchandise for sale, and so forth. A contractor is not in that class. A contractor does not sell cement; a contractor does not sell steel; a contractor does not sell wire and the other materials which go into the building of a building; and, when he is on an accrual basis, it does not make any difference how much merchandise he has got on hand. The pertinent and relevant fact is: How much of an obligation have you incurred in the purchase of merchandise and materials? If you have incurred an obligation, you must take it as a deduction in the year in which you incurred it. If you have used that merchandise to a point where you are entitled to be reimbursed for it by the owner, you can bill him with the absolute right

to demand payment, and you must accrue it as revenue or as income that year. It does not make any difference how much extra or excess material there may be on hand.

I want to take sharp issue with counsel when he says we had accrued on our books as income moneys expended for merchandise and materials that had not been used up so we could not render a bill for it. If we could not render a bill, we could not accrue the item because we had no right to receive [42] payment, and that is the basis of income, the right to receive. If the contract says we are entitled to payment when a building, for instance, is completed, we cannot be paid when it is only partially completed. There can never be an accrual in any case where we have not the absolute right to render a bill with the expectation and the right to receive payment.

I think those are the issues that have been raised, challenging our accrual method, your Honor.

Mr. Winter: They say they are on an accrual basis but, if so, the income has to be accrued as the statute and regulations say. If the method which the taxpayer uses does not clearly reflect income, he must use a method which does clearly reflect income. By this method they have not done so.

Counsel has now admitted that there is a great distortion of income. All the Commissioner did was to set up the records so that they could report on a percentage-of-completion basis, percentage of the profit to the costs which were expended, and that is the only fair and the only reasonable method

which could be adopted under the circumstances.

The Court: Suppose we recess now, and then you gentlemen come back at 2:30 to mark your exhibits.

(Recess.) [43]

The pre-trial conference in the above-entitled cause was resumed at 2:30 o'clock p.m., Monday, January 12, 1948.

Pre-trial Exhibits were thereupon marked as follows:

PLAINTIFF'S PRE-TRIAL EXHIBITS

Mr. Bischoff: I offer in evidence, as Plaintiff's Pre-trial Exhibit No. 1, letter dated July 7, 1938, from the office of the Commissioner of Internal Revenue to Ross B. Hammond, signed "Milton E. Carter, Acting Commissioner", granting permission to adopt the accrual method of accounting beginning with the taxable year ending December 31, 1938.

(Letter dated July 7, 1938, Commissioner of Internal Revenue to Ross B. Hammond, thereupon marked Plaintiff's Pre-trial Exhibit No. 1.)

Mr. Bischoff: I offer as Plaintiff's Pre-trial Exhibit No. 2 bill of sale, from Ross B. Hammond to William A. Hammond, of 25 per cent undivided interest in the business of Ross B. Hammond Co., dated February 3, 1942.

(Bill of Sale, R. B. Hammond to William A. Hammond, dated February 3, 1942, thereupon marked Plaintiff's Pre-trial Exhibit No. 2.)

Mr. Winter: We admit the execution of the instrument but deny that it has any legal effect; and it is not binding on the United States or the defendant Collector. [44]

Mr. Bischoff: I offer as Plaintiff's Pre-trial Exhibit No. 3 contract or agreement and articles of partnership between Ross B. Hammond and William A. Hammond, dated February 3, 1942, being the partnership agreement between the parties.

Mr. Winter: We admit the execution of the agreement but as to whether or not it was executed on the date it bears we insist on strict proof and object to it; it is not binding on the United States or the defendant Collector.

(Agreement and Articles of Partnership dated February 3, 1942, between Ross B. Hammond and William A. Hammond thereupon marked Plaintiff's Pre-trial Exhibit No. 3.)

Mr. Bischoff: I offer as Plaintiff's Pre-trial Exhibit No. 4 agreement between Ross B. Hammond, doing business as Ross B. Hammond Co., and Henry Mason, dated February 3, 1942.

Mr. Winter: We have no objection.

(Agreement dated February 3, 1942, between Ross B. Hammond and Henry M. Mason, thereupon marked Plaintiff's Pre-trial Exhibit No. 4.)

Mr. Bischoff: I offer as Plaintiff's Pre-trial Exhibit No. 5 agreement between Ross B. Hammond and A. V. Petersen, dated February 3, 1942.

Mr. Winter: No objection.

(Agreement dated February 3, 1942, between Ross B. Hammond and A. V. Petersen thereupon [45] marked Plaintiff's Pre-trial Exhibit No. 5.)

Mr. Bischoff: I call for the production of original income tax returns of Ross B. Hammond for the tax years 1938 to 1944, inclusive.

Mr. Winter: You realize that these cannot be left in court. They cannot be out of the hands of the Commissioner. I have them here right now, but copies will have to be substituted for the originals.

Mr. Bischoff: It will be agreeable to the plaintiff that the defendant may substitute photostatic copies of the returns in lieu of the originals.

(Plaintiff's Pre-trial Exhibit No. 6 reserved for income tax returns of Ross B. Hammond for the years 1938 to 1944, inclusive.)

Mr. Bischoff: May we stipulate that we may, for the time being, use the retained copy, the taxpayer's retained copy for the year 1944, with the understanding that you will supply a photostatic copy of the original before the close of the trial or while the Court has the case under advisement?

Mr. Winter: I haven't any objection to using your copy.

Mr. Bischoff: We have another copy for our use.

Mr. Winter: If you will put it in there, I will have it photostated, and we will have that done also.

Mr. Bischoff: All right. I will lend you now the taxpayer's [46] retained copy of the 1944 return, and that may now, for the present, be used in lieu of the original, with permission to the Government to substitute a photostatic copy, a certified copy.

Mr. Winter: A photostatic copy. It does not have to be certified. The only objection is that it is incompetent, irrelevant and immaterial.

Mr. Bischoff: I call for the production of the partnership returns for the years 1942 to 1944, inclusive.

Mr. Winter: I only have the returns for 1942 and 1943. Have you got a copy of the 1944 return?

Mr. Bischoff: I have a copy of the 1944 return.

Mr. Winter: We will have it photostated, the same as the other.

Mr. Bischoff: We will stipulate that plaintiff's retained copy may, for the present, be used in lieu of the original, with the understanding that the defendant will cause a photostatic copy to be substituted for the retained copy and the retained copy returned to the plaintiff.

I offer in evidence as Plaintiff's Pre-trial Exhibit No. 7 the partnership return for the years 1942, 1943 and 1944.

Mr. Winter: We have no objection to the returns, as such, having been filed, but we deny that the partnership did in fact exist. However, we admit that the returns were filed with the Collector as shown thereon. [47]

(Plaintiff's Pre-trial Exhibit No. 7 reserved for partnership income tax returns for the years 1942, 1943 and 1944.)

Mr. Bischoff: I call for the production of the returns of William A. Hammond for the years 1942, 1943 and 1944.

Mr. Winter: I have those.

Mr. Bischoff: We can make the same stipulation as to photostating?

Mr. Winter: Yes.

Mr. Bischoff: I offer as Plaintiff's Pre-trial Exhibit No. 8 the individual income tax returns of William A. Hammond for the years 1942, 1943 and 1944. Is there any objection?

Mr. Winter: No objection except that they are incompetent, irrelevant and immaterial to any issue in this case.

(Plaintiff's Pre-trial Exhibit No. 8 reserved for individual income tax returns of William A. Hammond for the years 1942, 1943 and 1944.)

Mr. Bischoff: I call for the production of the assessment of the tax deficiency made for the years 1938 to 1943, inclusive, and covering payments representing the assessment which is the subject matter of this litigation.

Mr. Winter: We have here, Mr. Bischoff, the certificate of the Collector certifying the assessment and payments during 1938 through 1943, which includes or shows the assessment for [48] the year 1943, which is the subject of this suit. The other assessments and payments are not material. I don't think any issue has been raised.

Mr. Bischoff: No. I notice, Mr. Winter, on the last page under the year 1943, in the column headed "Paid, abated or credited" there appears an item under date of August 18, 1945, \$6,554.03 credited.

Mr. Winter: Yes.

Mr. Bischoff: Does that represent the refund?

Mr. Winter: That is the refund which was credited that year; credited on the tax liability for 1943. The balance of the assessment or \$150,-592.87 was paid on August 17, 1945, under "Unidentified Account", the reason for that being that the assessment had not been received at the date of that payment.

Mr. Bischoff: In other words, may the record show the actual payment was received prior to August 17, 1945, but was held in abeyance until the application of the payment was determined by the Commissioner and was thereafter entered as of August 17, 1945?

Mr. Winter: No, it was paid on August 17, 1945, in the unidentified account.

Mr. Bischoff: With the understanding that the date appearing on the last item, 8/17/45, represents the date when the payment was made by the plaintiff, it may be stipulated that the certificate offered may be used in lieu of the original assessment [49] and record of payment.

Mr. Winter: Yes. That shows a certificate of the assessments and payment.

Mr. Bischoff: Yes. I now offer this certificate as Plaintiff's Pre-trial Exhibit No. 9.

Mr. Winter: No objection.

(Certificate of Assessments and Payments 1938 to 1943, inclusive, thereupon marked Plaintiff's Pre-trial Exhibit No. 9.)

Mr. Bischoff: I now call for the production of the claim for refund, Form 843, for the sum of \$6,536.10.

Mr. Winter: I have a photostat of that, Mr. Bischoff.

Mr. Bischoff: If you will show it to me.

Mr. Winter: Yes.

Mr. Bischoff: Let the record show that counsel for the defendant is tendering in lieu of the original a photostatic copy of the claim.

Mr. Winter: I have the original here, Mr. Bischoff.

Mr. Bischoff: In lieu of the original.

Mr. Winter: I have the original in court and we are asking leave to substitute a copy. You have no objection?

Mr. Bischoff: I have no objection to the substitution of a copy.

Mr. Winter: Do you want to see the original?

Mr. Bischoff: No; if you will tell me that is a true copy, [50] that will be sufficient, Mr. Winter. Do you want to make that statement?

Mr. Winter: Yes. It is right here. Here is the original.

Mr. Bischoff: We now offer as Plaintiff's Pre-trial Exhibit No. 10 the claim for refund for the sum of \$6,536.10, dated January 16, 1945.

(Photostatic copy of claim for refund, Ross B. Hammond, dated January 16, 1945, in the

amount of \$6,536.10, thereupon marked Plaintiff's Pre-trial Exhibit No. 10.)

Mr. Bischoff: I call for the production of the claim for \$150,592.87, dated August 22, 1945. You have tendered a photostatic copy, Mr. Winter, and I would like to check it with the original.

Mr. Winter: Here is the original right here.

Mr. Bischoff: Let the record show that counsel for the defendant has produced a photostatic copy of the document called for and represents that it is a true copy, and I now offer it as Plaintiff's Pre-trial Exhibit No. 11.

Mr. Winter: No objection.

(Photostatic copy of claim for refund, Ross B. Hammond, dated August 22, 1945, in amount \$150,592.87, thereupon marked Plaintiff's Pre-trial Exhibit No. 11.)

Mr. Winter: The original claim is here in court.

Mr. Bischoff: I now call for the production of the Revenue Agent's reports of the audit of the income tax returns of Ross B. Hammond for the tax year 1938, one being dated January 24, 1940, and the other being dated January 27, 1941.

Mr. Winter: I do not have those. The report was furnished to you. Have you got the report there? I have no objection to using a copy. You have the original, though.

Mr. Bischoff: I don't know whether we got the originals or copies, to tell you the truth, but we have copies, I think.

I offer as Plaintiff's Pre-Trial Exhibit No. 12 the Revenue Agent's report for the tax year 1938, dated January 24, 1940.

Mr. Winter: We object to it except as the Commissioner may have followed the computations. The Revenue Agent's report manifestly is not evidence except to show the basis upon which the Commissioner determined the tax liability.

Mr. Bischoff: Is there any question about the authenticity?

Mr. Winter: No, we admit that it is a report furnished to the taxpayer upon completion of the examination, showing the basis of the Agent's findings which may or may not be accepted by the Commissioner in all respects. It has no value except to show the basis upon which the Commissioner may have acted.

(Revenue Agent's report dated Jan. 24, 1940, addressed to Ross B. Hammond and signed by Internal Revenue Agent in Charge, thereupon [52] marked Plaintiff's Pre-Trial Exhibit No. 12.)

Mr. Bischoff: I offer as Plaintiff's Pre-Trial Exhibit No. 13, Revenue Agent's report for the year 1938, dated January 27, 1941.

Mr. Winter: I object to it as incompetent, irrelevant and immaterial, not within any issue in this case.

Mr. Bischoff: Any question about its authenticity?

Mr. Winter: No. It apparently is a report furnished to the taxpayer covering that year.

(Revenue Agent's report dated January 27, 1941, addressed to Ross B. Hammond by Internal Revenue Agent in Charge, for year 1938,

thereupon marked Plaintiff's Pre-Trial Exhibit No. 13.)

Mr. Bischoff: I offer as Plaintiff's Pre-Trial Exhibit No. 14 Revenue Agent's report for the tax year 1939, dated January 27, 1941.

Mr. Winter: The same objection as No. 12 and No. 13. It does not appear to be involved in any issue in this case concerning the years here involved and it manifestly is not evidence.

(Revenue Agent's report dated January 27, 1941, addressed to Ross B. Hammond, for 1939, thereupon marked Plaintiff's Pre-Trial Exhibit No. 14.) [53]

Mr. Bischoff: I offer as Plaintiff's Pre-Trial Exhibit 15 Revenue Agent's report for the tax year 1939, dated March 1, 1943.

Mr. Winter: The same objection as to Exhibits 11, 12, 13 and 14.

(Revenue Agent's report March 1, 1943, addressed to Ross B. Hammond, 1939, thereupon marked Plaintiff's Pre-Trial Exhibit No. 15.)

Mr. Bischoff: I offer as Plaintiff's Pre-Trial Exhibit No. 16 Revenue Agent's report for the tax year 1940, dated June 12, 1941.

Mr. Winter: The same objection as to previous exhibits of this nature.

(Revenue Agent's report dated June 12, 1941, to Ross B. Hammond, for 1940, thereupon marked Plaintiff's Pre-Trial Exhibit No. 16.)

Mr. Bischoff: I offer as Plaintiff's Pre-Trial Exhibit No. 17 Revenue Agent's report for the tax year 1940, dated March 1, 1943.

Mr. Winter: The same objection.

(Revenue Agent's report dated March 1, 1943, to Ross B. Hammond, for 1940, thereupon marked Plaintiff's Pre-Trial Exhibit No. 17.)

Mr. Winter: I cannot see the materiality of any of these Revenue Agent's reports covering years that are not involved here.

Mr. Bischoff: I offer as Plaintiff's Pre-Trial Exhibit No. 18 Revenue Agent's report for the tax year 1941, dated March 1, 1943.

Mr. Winter: The same objection as to previous exhibits, No. 12 to No. 17, inclusive. I want the further objection to be shown in the record that no tax liability is involved for any of those years, except overpayment for 1941, which was the subject of a separate report.

(Revenue Agent's report dated March 1, 1943, to Ross B. Hammond, for 1941, thereupon marked Plaintiff's Pre-Trial Exhibit No. 18.)

Mr. Bischoff: I offer as Plaintiff's Pre-Trial Exhibit No. 19 Revenue Agent's report for the tax year 1941, dated November 6, 1944.

Mr. Winter: We have no objection.

(Revenue Agent's report dated November 6, 1944, to Ross B. Hammond is re over-assessment of \$6,536.10, thereupon marked Plaintiff's Pre-Trial Exhibit No. 19.)

Mr. Bischoff: I offer as Plaintiff's Pre-Trial Exhibit No. 20 Revenue Agent's report for the tax year 1943, dated [55] November 6, 1944.

Mr. Winter: No objection.

(Revenue Agent's report dated November 6, 1944, to Ross B. Hammond, in re deficiency \$145,537.77, thereupon marked Plaintiff's Pre-Trial Exhibit No. 20.)

Mr. Bischoff: I offer as Plaintiff's Pre-Trial Exhibit No. 21 a bundle of duplicate original monthly billings made by the plaintiff, described in the Revenue Agent's reports for the tax years 1941 to 1944, inclusive.

Mr. Winter: What is the purpose? How can any good purpose be served in this case by having a big bundle of monthly billings? It is admitted the monthly billings were made. What do you contend for them?

Mr. Bischoff: Do I understand it is admitted that monthly billings were made in the years in question totaling the amounts shown in the Revenue Agent's reports for the years in question?

(Discussion.)

Mr. Winter: There is no issue between us as to the gross receipts. The only issue is whether or not the books clearly reflect the income and the returns clearly reflect the income in the years when it was earned, or whether the income was distorted.

Mr. Bischoff: Let me ask you this question, and it may clarify the whole matter. I am addressing this question to [56] Mr. Winter and to Mr. Williams, the Revenue Agent. Is there going to be any question that we had the right to bill the owners in accordance with the billings that we have here and upon which we accrued the income in these years?

Mr. Williams: There is no question as to your right, no, sir. The contracts provide as to how the billings shall be made.

Mr. Bischoff: If no issue is going to be raised as to our right to bill in any month for the particular amount that we did bill, then these duplicate billings will not be material and I will not offer them in evidence.

Mr. Williams: There is one point in there that you might discuss. Those billings were made on the basis of the engineer's estimates and the estimates were not, in the case of the month of December, for instance, billed up to December 31st.

Mr. Winter: There is no use spending a lot of time. They may be identified in the pre-trial, and then plaintiff may offer them.

Mr. Bischoff: The bills were rendered in accordance with the estimates which were approved for the month in which the bills were rendered. If there is going to be any issue about that, I want to offer these in evidence.

Mr. Winter: You mean you want to have them identified in the pre-trial order. They are not offered in evidence yet.

Mr. Bischoff: I will have them identified and offer them [57] at the trial, but if there will not be any issue on that subject, I do not want to clutter up the record.

Mr. Winter: You may have them identified in the pre-trial because we might want to use them.

(Bundle of duplicate original monthly billings made by plaintiff thereupon marked Plaintiff's Pre-Trial Exhibit No. 21.)

Mr. Winter: There is no objection to them being identified as plaintiff's billings but I want to reserve the right to object to the introduction of them unless they are tied up in some way to any issue in the case.

Mr. Bischoff: May we have at this time a statement from the defendant as to whether the defendant questions the accuracy of the billings upon that basis?

Mr. Winter: We question that the books were so kept that they reflect the true income of the taxpayer during the years 1942 and 1943; that the income was so distorted that 50 per cent profit on some contracts was reported in one year and a big loss on a million-dollar contract in another year. That is our position.

Mr. Bischoff: I will ask Mr. Williams and Mr. Winter specifically with respect to the billings as made. Do you, Mr. Williams, challenge the accuracy of the billings as made for any reason?

Mr. Winter: I don't think you need to answer that. Let [58] him identify his exhibits. We will bring that out at the trial.

Mr. Bischoff: I think we are entitled to an unequivocal answer from you, Mr. Winter. If you don't want——

Mr. Winter: I don't want——

Mr. Bischoff: If you do not want to answer, we can have the Court come in and require you to make a statement.

Mr. Winter: I don't know whether the billings were properly made or not.

Mr. Bischoff: Do you, Mr. Williams?

Mr. Williams: It would be impossible to determine, sir, without examining the billings themselves.

Mr. Bischoff: You did not question them in your report, did you?

Mr. Williams: It was not necessary to, sir.

Mr. Bischoff: All right. I offer as Plaintiff's Pre-Trial Exhibit No. 22 an envelope or bundle containing contracts pursuant to which the work was done, being the contracts described in the Revenue Agent's reports.

Mr. Winter: These are contracts with respect to 1941, 1942, 1943 and 1944?

Mr. Bischoff: Yes.

Mr. Winter: We have no objection.

(Bundle of contracts, referred to in Revenue Agent's reports, thereupon marked Plaintiff's Pre-Trial Exhibit No. 22.) [59]

Mr. Bischoff: Now, we want to offer for purposes of identification two journal books.

(Two journals, Ross B. Hammond Co., thereupon marked Plaintiff's Pre-Trial Exhibit No. 23-A and No. 23-B.)

Mr. Bischoff: I also offer for identification as Plaintiff's Pre-Trial Exhibit No. 24 the trial balance book of the plaintiff.

(Trial balance book of plaintiff, Ross B. Hammond Co., thereupon marked Plaintiff's Pre-Trial Exhibit No. 24.)

Mr. Bischoff: I would like to have the ledger of the plaintiff marked as Plaintiff's Pre-Trial Exhibit No. 25.

(Ledger of plaintiff, Ross B. Hammond, thereupon marked Plaintiff's Pre-Trial Exhibit No. 25.)

Mr. Bischoff: Those are all of the exhibits we have to offer.

DEFENDANT'S PRE-TRIAL EXHIBITS

Mr. Winter: On behalf of the defendant, we will offer the original returns of A. V. Petersen for the years 1942 and 1943.

Mr. Bischoff: Objected to as incompetent, irrelevant and immaterial and on the further ground that any controversy arising out of the receipt of profits by Mason and Petersen is barred by the statute of limitations and on the ground that [60] the controversy with respect thereto has been adjudicated by this court in a prior proceeding.

(Defendant's Pre-Trial Exhibit No. 26 reserved for original income tax returns of A. V. Petersen for 1942 and 1943.)

Mr. Winter: We will offer also the original returns of Henry M. and Elizabeth R. Mason for the years 1942 and 1943 and ask leave to substitute photostatic copies.

Mr. Bischoff: We make the same objection as to the last exhibit.

(Defendant's Pre-Trial Exhibit No. 27 reserved for income tax returns of Henry M. and Elizabeth R. Mason for 1942 and 1943.)

Mr. Bischoff: I wish to inquire in connection with the last exhibits. Have you the income tax returns for Mason and Petersen for the years, 1944, 1945 and 1946 here?

Court reconvened at 10:00 o'clock a.m., January 13, 1948.

Pre-Trial Proceedings (Continued)

Mr. Winter: We did not finish with identifying all the pre-trial exhibits. There are a few exhibits that we want to have marked.

The Court: All right.

Mr. Winter: I have here a letter from the taxpayer to the Commissioner, dated March 3, 1938, the Commissioner's reply of March 29, 1938, the taxpayer's letter to the Commissioner of April 5, 1938, the Commissioner's reply of April 25, 1938, and the taxpayer's letter of May 9, 1938. All of this is correspondence with respect to the granting of permission to report income tax, explaining the entire situation. We will offer these letters as Defendant's Pre-Trial Exhibit No. 28. I might explain to the Court that they are from the original files of the Commissioner of Internal Revenue and I would like leave to substitute photostatic copies of these communications, but they may be used during the trial, of course.

(Letters dated March 3, 1938, taxpayer to Commissioner; March 29, 1938, Commissioner to taxpayer; April 5, 1938, taxpayer to Commissioner; April 25, 1938, Commissioner to taxpayer; and May 9, 1938, taxpayer to Commissioner, [64] thereupon marked Defendant's Pre-Trial Exhibit No. 28.)

Mr. Bischoff: Plaintiff objects to the introduction of this tendered exhibit on the ground that it is incompetent, irrelevant and immaterial. The

only relevant issue is the consent that was given which is the culminating document issued by the Government. The correspondence which preceded it, we deem to be immaterial and just unnecessarily encumbering the record.

The Court: All the exhibits identified on each side will be admitted in evidence, subject to such objections as may have heretofore been stated or may hereafter be stated on the record, prior to final submission of the case.

Mr. Bischoff: I would like to qualify that, if I may, with respect to a few of these exhibits which were identified at the pre-trial conference. I intend to make a formal offer of these, with some qualifications, if your Honor will permit me to do it at this time.

The Court: Let us finish with the identification.

Mr. Bischoff: Very well.

Mr. Winter: We have here the computation made showing the income tax liability of Ross B. Hammond on a basis of 75 per cent of the income of the alleged partnership to Ross B. Hammond, exclusive of any credits to Mason and Petersen.

In other words, it is a computation which would be [65] for the information and guidance of the Court as showing the tax liability.

The Court in this case can find several bases of judgment, in my opinion. One is that the Commissioner did not err in making the accounting of the taxpayer's return as of May 2nd; also, that a partnership did or did not exist; and, third, the

hand about them or as to whether the computations are correct on any basis.

The Court: You will be given time to check them.

Mr. Bischoff: In the second place, your Honor, we object to the exhibit on the ground that the computations are made upon a basis which was not justifiable or permissible under the law or in fact.

Counsel for the defendant has stated the computations were made upon the basis of the disallowance of certain deductions that were taken representing the allocations to Petersen and Mason of their share of the profits in the years 1942 and 1943.

That issue has already been decided by this Court. The question of the allowance or disallowance of these two deductions was raised when the defendant moved in this court for [68] permission to interpose an offset or counterclaim raising the question that these two deductions were disallowed. We opposed the allowance of the filing of the amended answer tendering that counterclaim or offset on the ground that the statute of limitations had run against those items, and they were no longer subject to review for any purpose. The Court sustained our objection and that amended answer was never filed; that is, it was not filed for any purpose and is not now an issue in the case.

An attempt is now being made to drag that issue into this court through the back door, so to speak, by the tender of this computation and by some things that were said during the submission made

to your Honor; and we oppose this evidence and the introduction of any other evidence which will be an attempt to re-litigate that issue.

In other words, there are two basic objections. One is that the items are barred by the statute and the second is that your Honor has already adjudicated that issue.

The Court: It may be marked, subject to the objection.

Mr. Bischoff: Have you a copy of these statements?

Mr. Winter: No, I do not have. I will have copies made, Mr. Bischoff. I am always glad to furnish any copies, but I have not received one copy of any of your exhibits.

Mr. Bischoff: You have had all the exhibits you asked for.

Mr. Winter: I will be glad to make you a copy.

Mr. Bischoff: Very well. [69]

Mr. Winter: I might say, your Honor, along that line that the exhibit is a computation taken from the books and from the returns which are in evidence and it is merely to help the Court. I think the Court can see the computation much clearer than by going through these returns and books and figuring this all out.

Mr. Bischoff: Mr. Winter, in connection with your last statement, was that computation made on the information contained in the books or was the computation made upon the theory assumed by the Revenue Agent?

Mr. Winter: The computation was made from

the books, by disallowing the \$43,000 to Mr. Petersen, as shown on the return, and it taken from the books and from the returns; nothing extraneous.

Mr. Bischoff: Do you now claim that there are any entries in the books showing the disallowance of the Mason and Petersen profit in the two years in question?

Mr. Winter: The books don't show. There was nothing in the journal and we don't see that there was any capital account with Mr. Petersen and Mr. Mason. The books exhibited to us do not show any capital account but show a deduction of that amount as accrued liability and we say, under the contract which is in evidence, that it was not accrued, not an accrued liability, and could not be accrued because there was no right to receive it unless they were partners and they are admittedly not partners. [70]

Mr. Bischoff: In view of counsel's statement, I make the additional objection that it now appears that the document was prepared in part only upon the books and records of the company and in part upon the conclusions of the Revenue Agent as to the proper treatment, having decided for himself questions of law and fact upon which it was predicated.

The Court: It will be admitted subject to objection.

Mr. Winter: Now, then, the power of attorney. Mr. Jacob, you gave to us a copy of the power of attorney. Do you have that power of attorney from William A. Hammond?

Mr. Bischoff: Is that a copy?

Mr. Winter: That is the copy that was given to us.

Mr. Bischoff: If it is a copy, we can stipulate.

Mr. Winter: We will offer as Defendant's Pre-Trial Exhibit No. 30 the power of attorney from William A. Hammond. I understand counsel has no objection. He says it is a copy and, since it is also a part of the official record, we would like to ask leave to withdraw this and make a photostatic copy.

Mr. Bischoff: No objection, your Honor.

(Copy of Power of Attorney, dated February 3, 1942, William A. Hammond to Ross B. Hammond, thereupon marked Defendant's Pre-Trial Exhibit No. 30.)

Mr. Bischoff: As I understand, we are still in pre-trial. In that connection, some question was raised last night during [71] the pre-trial conference, in your Honor's absence, in connection with the introduction of exhibits, that there might be some other records that ought to be here. We caused an examination to be made, and we produce two records upon what might be called the subsidiary ledger account of A. V. Petersen and H. M. Mason. They are a part of a volume which is a subsidiary ledger. It is a looseleaf ledger and we have taken out two pages which represent these accounts. I will ask permission of the Court to do so, without offering the whole book in evidence, because it is currently in use and we know of no reason for the use of any of the other parts of the book

unless counsel on the other side suggests some other parts that might be pertinent. In the absence of that, we will ask to have marked for identification these two ledger accounts of Mason and Petersen.

Mr. Winter: We have no objection to them being marked at this time. However, this is the first time, on pre-trial, that we have ever found out about the existence of this book. In fumbling through it rather hurriedly, I see it only refers, outside of these two ledger sheets which counsel says he took from there and which refer back to 1938—the book apparently, so far as I have been able to find out, does not go back beyond 1945. I think it should be properly identified so that we know what it is. We had not seen it before. I don't know whether it is complete or not.

Mr. Bischoff: There will be further identification, your [72] Honor. My explanation was only with respect to the matter of taking out the two sheets instead of offering the whole book.

There will be evidence as to the system of accounting that they maintained. They kept a separate record for every contract, as they were required to do by certain requirements, and, whenever a job was completed, they took out of this subsidiary ledger all portions of the account dealing with the specific contract, and these pages, dealing with the account, are filed with the record of that particular contract. That explains the absence of a great many pages which would normally be in there.

Mr. Winter: I think, along the same line, we would like to have the entire book identified, because there appears to be a sheet relating to William A. Hammond which does not even appear to be on the same type of paper as shown by the book. I don't know when it was made. It was here just a minute ago. That does not even appear to be on the same type of paper as the other.

Mr. Bischoff: Well, it goes back to 1940, and they were using different pages.

Mr. Winter: No capital account is shown as being set up until 1943.

Mr. Bischoff: We will avoid any question about that by asking that these two pages be marked for identification as Plaintiff's Pre-Trial Exhibit 31 and 32, the sheet pertaining [73] to Petersen being No. 31 and the sheet pertaining to Mason being No. 32. We offer them only for identification at this time, your Honor.

Mr. Winter: Don't you want the sheet pertaining to William A. Hammond identified?

Mr. Bischoff: I don't know. We will see. We might.

(Subsidiary Ledger Account A. V. Petersen thereupon marked Plaintiff's Pre-Trial Exhibit No. 31.)

(Subsidiary Ledger Account H. M. Mason thereupon marked Plaintiff's Pre-Trial Exhibit No. 32.)

Mr. Bischoff: In view of counsel's last statement, with its implication, I am offering for iden-

tification the sheet containing W. A. Hammond's account.

Mr. Winter: I think counsel ought to identify the entire book.

Mr. Bischoff: We are going to offer the whole book.

Mr. Winter: I don't have any objection to doing that except that it is not material.

Mr. Bischoff: I do not want to have any implication left in this case.

(Ledger Account of W. A. Hammond thereupon marked Plaintiff's Pre-Trial Exhibit No. 33.) [74]

Mr. Bischoff: I want to offer then for identification the rest of the subsidiary ledger, which has been the subject of discussion, your Honor.

(Subsidiary Ledger, less Plaintiff's Pre-Trial Exhibits, 31, 32 and 33, thereupon marked Plaintiff's Pre-Trial Exhibit No. 34.)

Mr. Bischoff: We offer also, may it please the Court, a subsidiary account to show the breakdown and allocation of the capital account to the partners.

Mr. Winter: I object to it on the ground it is not properly identified, has not been properly identified. It has not been shown when it was made.

Mr. Bischoff: We are offering it for identification. It will be up to us to prove it.

The Court: It may be marked.

(Sheet from Subsidiary Ledger in re Capital Account thereupon marked Plaintiff's Pre-Trial Exhibit No. 35.)

Mr. Bischoff: I think, your Honor, that closes the pre-trial proceedings.

Mr. Winter: I don't think we have any further documents to be marked. [75]

PROCEEDINGS OF TRIAL

The Court: Now, to save the specific offer of all exhibits, we will do what we usually do in tax cases, receive in evidence all exhibits that have been identified. I don't know whether we are going to run into trouble or not, Mr. Bischoff. I don't know what you had in mind, but you identified two or three exhibits a while ago.

Mr. Bischoff: I will state to your Honor what I have in mind. There are certain exhibits that I want to offer in evidence and certain exhibits that were marked as pre-trial exhibits yesterday that I do not want to offer in evidence. It may become necessary later on but I want to avoid offering them at this time because it probably won't be necessary to encumber the record. They are very voluminous.

The Court: Just call the numbers off, either one way or the other.

Mr. Bischoff: I now offer in evidence the documents and records which were numbered as Plaintiff's Pre-Trial Exhibits 1, 2, 3, 6, 7, 8, 9, 10, 11, 12, 13, 14, 15, 16, 17, 18, 19, 20 and 35.

The Court: They are all admitted subject to such objections as have been heretofore stated or may hereafter be stated prior to final submission of the cause.

Plaintiff's Pre-Trial Exhibits Nos. 1, 2, 3, 6, 7, 8, 9, 10, 11, 12, 13, 14, 15, 16, 17, 18, [76] 19, 20 and 35, respectively, were thereupon received in evidence and marked Plaintiff's Exhibits Nos. 1, 2, 3, 6, 7, 8, 9, 10, 11, 12, 13, 14, 15, 16, 17, 18, 19, 20 and 35.)

[Printer's Note]: Plaintiff's Exhibit No. 1 is set out at page 518. Exhibit No. 3 is set out at page 519. Exhibit No. 6 is set out at page 534. Exhibits Nos. 12, 13, 14, 15, 16, 17, 18, 19 and 20 are set out at pages 553-619 of this printed record. Exhibit No. 35 is set out at page 650.

Mr. Bischoff: And we offer for identification only at this time Plaintiff's Pre-Trial Exhibits numbered, respectively, 21, 22, 23, 24 and 25.

The Court: They are admitted for identification.

Mr. Winter: What about 4 and 5?

Mr. Bischoff: I am not offering 4 and 5. You may offer them, if you want to, but I am not going to.

Mr. Winter: The Government will offer Plaintiff's Pre-Trial Exhibits 4 and 5 which were identified at the pre-trial yesterday.

The Court: Admitted.

(Plaintiff's Pre-Trial Exhibits 4 and 5 were thereupon received in evidence and marked Defendant's Exhibits No. 4 and No. 5.)

[Printer's Note]: Plaintiff's Pre-Trial Exhibits Nos. 4 and 5 are set out as Defendant's Exhibits 4 and 5 at pages 525-533.

Mr. Winter: The Government will also offer Defendant's Pre-Trial Exhibits 26 to 30, inclusive. I think that covers all of the exhibits, if the Court please.

The Court: They are admitted.

(Defendant's Pre-Trial Exhibits No. 26 to No. 30, inclusive, thereupon received in evidence and marked Defendant's Exhibits Nos. 26 to No. 30, inclusive.) [77]

[Printer's Note]: Defendant's Exhibits Nos. 26, 27, 28 and 29 are set out at pages 620-647.

Mr. Bischoff: I want to object to the introduction of these exhibits in evidence, may it please the Court, on the ground that it is an attempt to re-litigate an issue which your Honor has already litigated and adjudicated.

The Court: What are you referring to by that?

Mr. Bischoff: All of them being regarding the deduction of the allocation of the profit to Mason and Petersen in the tax year 1943 and 1942, which was adjudicated in connection with the motion of the defendant to file an amended answer tendering a counterclaim or offset based upon these two transactions. Your Honor determined that the items were barred by the statute of limitations and there was an adjudication on that, and they are not now the subject of any issue in this case. We add the further objection that the Revenue Agent's reports upon which this tax assessment was made and

paid did not raise any issue as to the deductibility or the right to deduct these items in computing our income tax for the years in question, and it has no place in this case.

The Court: They are admitted, subject to objection.

The Court: Call a witness. [78]

ROSS B. HAMMOND,

the plaintiff herein, was thereupon produced as a witness in his own behalf, and, being first duly sworn, was examined and testified as follows:

Direct Examination

By Mr. Bischoff:

Q. Mr. Hammond, you are the plaintiff in this action? A. I am.

Q. Where do you live?

A. Portland, Oregon.

Q. How old are you? A. Fifty-eight.

Q. How long have you lived in this community?

A. Since 1920.

Q. Prior to that where did you live?

A. Detroit, Michigan.

Q. What is your occupation?

A. Building contractor.

Q. How long have you been engaged in that occupation? A. Since 1910.

Q. Have you followed that business and occupation during all the time you have lived in Oregon?

A. I have.

Q. That is, in Portland, Oregon?

A. I have, yes.

(Testimony of Ross B. Hammond.)

Q. Will you state the nature of the construction work that [79] you do, that is, what kind of construction work?

A. It is almost exclusively building construction.

Q. Can you name some of the buildings that you have constructed in Oregon?

A. Well, we built the north half of the Pittock Block, the Bedell Building, the Pacific Building, quite a number of city schools, the State Capitol and several large——

Q. At Salem?

A. At Salem. Do you want me to stay in Portland?

Q. Just the important ones, yes.

A. We are just finishing the Equitable Building.

Q. Did you build this Federal Courthouse we are in now?

A. I built this, about 90 per cent as a subcontractor; built the Stadium.

Q. That will be sufficient to illustrate the kind of work you are doing. During your operations here, did you operate in your own name as an individual or did you operate during any of the time as a corporation or a partnership?

A. I operated first as a corporation, then as an individual, and now as a partnership.

Q. When was the partnership formed?

A. As I remember, it was in February, 1942; the exact date I am not sure of, I think the 3rd.

(Testimony of Ross B. Hammond.)

Q. I show you Plaintiff's Exhibit No. 2 and ask you if that is your signature on that document?

A. Yes, sir.

Q. Did you execute it on the date it bears?

A. Yes, sir.

Q. Did you deliver that to your son, William A. Hammond, who is named in that document?

A. Yes.

Q. What is that instrument?

A. This is a partnership agreement.

Q. Wait a minute. Look at it carefully.

A. I am sorry. Pardon me.

Q. That is a bill of sale of an interest in your business?

A. That is correct, selling him a 25 per cent interest.

Q. I show you Plaintiff's Exhibit No. 3 and ask you if that bears your signature?

A. Yes, sir.

Q. Was that executed on the date it bears?

A. Yes, sir.

Q. Is your son's signature on there?

A. Yes, sir.

Q. Did he sign it in your presence?

A. I presume so.

Q. Signed in your presence? A. Yes.

Mr. Bischoff: Your Honor, would you care for me to make a brief statement as to the high spots of the instruments? [81]

Plaintiff's Exhibit No. 2 is a bill of sale by which the plaintiff sells to William A. Hammond

(Testimony of Ross B. Hammond.)

a 25 per cent undivided interest in and to all the rights, interests and assets of every kind and character whatsoever now owned and used by the plaintiff in the business done and conducted in the name of Ross B. Hammond Co. I think that is all that need be said about that.

The Court: What is the date?

Mr. Bischoff: February 3, 1942. Plaintiff's Exhibit No. 3 is an instrument entitled "Agreement and Articles of Partnership" and recites that William A. Hammond has directed his studies and education to the end that he might become associated with the company as a member of the firm, and that he has completed his education and qualified himself as an expert construction engineer and has been for some time in the employ of the Ross B. Hammond Company in that capacity; and recites that, after serving a short time in the armed forces, he was rejected from the service; that the company is bidding upon projects and proposes to engage in extensive construction contracts in furtherance of the defense program of the United States; that Ross B. Hammond desires to be relieved of some of the duties and responsibilities of the management of said business and desires to further develop the knowledge and experience of William A. Hammond in the construction field; and it recites the sale to William A. Hammond of a one-fourth interest. [82]

(Testimony of Ross B. Hammond.)

Then, it is agreed that the partnership began on the 3rd day of February, 1942, and shall continue during the joint life of the parties, unless dissolved by action of the parties; and then it describes generally the character of the business that is to be done, where the place of business is to be; and provides for the respective interests in the partnership of 75 per cent to Ross B. Hammond and 25 per cent to William A. Hammond; that the partnership assumes all the liability of Ross B. Hammond Company including liabilities incurred by Ross B. Hammond in the agreements entered into with Mason and Petersen covering their employment upon a profit-sharing basis; and they agree to share the profits and losses upon the basis indicated.

The agreement provides as to the amount of drawings which would be permissible by the partners, Ross B. Hammond being permitted to draw \$22,500 per annum and William A. Hammond \$7500 per annum. It is further agreed that if the total income for any year exceeds \$30,000 the capital shall be permitted to remain in the business, and reciting the reasons therefor—that there is need for working capital to finance large contracts which were in operation.

The Court: Was there ever a corporation?

Mr. Bischoff: I beg your Honor's pardon?

The Court: Was there ever a corporation?

Mr. Bischoff: There was, up to the end of 1937.

(Testimony of Ross B. Hammond.)

The Court: Then he operated as an individual?

Mr. Bischoff: Then the corporation was dissolved as of the end of that year and he operated as an individual.

The Court: And then as partners?

Mr. Bischoff: From that time, your Honor, from January 1, 1938, to the time this partnership was formed, he operated as an individual.

The Court: Was there any other son in the family?

Mr. Bischoff: No. He is the only son. Is that correct? A. That is correct.

Mr. Bischoff: He is the only son. The agreement provides that the partners shall have equal voice in the control of the business and the operation of the partnership.

The Court: What was the son's age?

Mr. Bischoff: Q. Mr. Hammond, how old was your son in 1942, at the beginning of 1942 when the partnership agreement was made?

A. Well, he is thirty now. That would make him twenty-four then.

The Court: Had he finished college?

A. Oh, yes.

The Court: You ask the questions.

Mr. Bischoff: In a moment I will be through with this contract. I intend to ask him all of these questions, if your Honor will permit me.

The provision is further made for the keeping of books [84] and accounts and access to the accounts by both partners. Those are the high spots of these two exhibits, your Honor.

(Testimony of Ross B. Hammond.)

Q. Mr. Hammond, what education did your son, William, get preparatory to carrying on the contracting business?

A. Well, he studied engineering and graduated from Stanford University as a civil engineer.

Q. Can you tell us in what year he graduated from Stanford University?

A. I forget. I will have to get some help from my son.

Q. Give us your own best recollection.

A. It was about 1940. I think it was 1940.

Q. 1940? A. Yes.

Q. Prior to graduation from Stanford what schooling did he have besides the engineering course at Stanford?

A. He graduated from Culver and had gone a couple of years to Washington High School and the public school at Eastmoreland.

Q. Prior to his graduation from Stanford University did your son do any work in connection with your contracting business?

A. He worked summers during vacations with the company, yes, as a laborer.

Q. Over what period of time did he put in any work, working with your company during the school period? A. During the vacations?

Q. Yes. [85]

A. Well, he worked nearly every vacation.

Q. How old was he when he first began to work with you?

A. Oh, he was probably seventeen or eighteen.

(Testimony of Ross B. Hammond.)

Q. Did you have any plans for him with respect to the work he was to engage in, from the time he was a child?

A. I think they started when he was ten.

Q. Tell us what your intentions were and what plans you made for his training and for what occupation? Tell us that without going into too great detail.

A. Well, we had many discussions, his mother and myself, with him over quite a period of time. He wanted to be in the contracting business and, as a matter of fact, we tried to dissuade him but he was going to be in the contracting business.

Q. When you became convinced that was what he wanted, did you do anything towards perfecting him to qualify him for that business?

A. Then we put him through Stanford and during vacations I spent a lot of time trying to develop his construction knowledge, and developed in the same way I would develop and had developed all the rest of the organization.

Q. Will you be a little more specific as to what you had him do from the ground up, so to speak, about learning various phases of the business?

A. I sent him out on the job under a superintendent, as a laborer, and then put him on as a timekeeper; from there, I put [86] him on as an engineer in charge of a job and from then to a superintendent in charge of a job and from then to assistant general superintendent and, of course,

(Testimony of Ross B. Hammond.)

I could train him a whole lot more specifically than I could some of the rest of the boys.

Q. Did you do all that pursuant to a plan that you had for his development in your business?

A. As he expressed it definitely that he was going in the contracting business, I wanted him in business with me, and of course I developed him for that purpose, with his consent, at the time.

Q. This training you were giving him, was that casual or was that intensive training?

Mr. Winter: The last three questions have been very leading. I don't think the witness should be led.

The Court: He may answer. What was the nature of the training?

Mr. Bischoff: Q. What was the nature of the training, whether it was casual or intensive?

A. Very, very intensive and concentrated.

Q. Did you move him along at the same rate as other employees were moved along?

A. Possibly we moved him along much faster with that type of training.

Q. When you were together, then, at home and otherwise, did you discuss **problems of construction** with him? [87]

A. To the extent that we were not very well liked by his mother.

Q. Well, in the early stages of development was there any discussion at home as to his association with you in business?

(Testimony of Ross B. Hammond.)

A. My impression was that he wanted to be on his own; among things, he wanted to go to South America, like all other construction young people do.

Q. What did you do when you learned of that inclination?

A. Put on quite a sales campaign to talk him out of it.

Q. Was that subject a subject of discussion in the family between your wife and William and yourself? A. Yes.

Q. Over what period of time did those discussions continue?

A. Oh, from the time he graduated from Stanford and came to work for us.

Q. When you learned of his inclination to go to South America, what did you do then?

A. All this developed very rapidly and was crystallized with him. The fact he was called into the service changed a lot of plans.

Q. What I am trying to get at, Mr. Hammond is whether the inclination he had to go to South America had anything to do with your ultimate determination to take him into partnership?

A. Very much.

Q. When did you express that intention, then, and what was done in that respect? Ultimately, what was decided upon?

A. Because he was a reserve officer, he finally was taken into [88] the service. He did not get a physical examination here but was sent to Fort

(Testimony of Ross B. Hammond.)

Lewis first and within three or four days—I think the examining officer advised him that he would not be able to stay in the Army but that it would take thirty or sixty days probably get him back out, and that was the first time that we knew that he was going to be out or that he was going to stay out.

At that time I discussed it with his mother and, when he got back, I had crystallized a set of plans to make Bill a partner, if he was willing to be a partner, and make a deal with the other two boys who I was also raising in the construction business.

Q. Those two boys were who?

A. Mr. Petersen and Mr. Mason.

Q. They had been with you for some time?

A. Yes, and gone through the same training that Bill had except a little longer time.

Q. How long before February 3, 1942, was it that Bill was discharged because of disability, approximately?

A. You mean when he was back here or received his discharge? That was only a few days before that. I mean, it was shortly after he got back, actually back into Portland.

Q. That is when you took up this matter of a partnership?

A. Took it up almost immediately.

Q. Are those the discussions that culminated in the making of [89] the agreement, which is Plaintiff's Exhibit No. 3, Exhibits 2 and 3?

A. The agreements with Petersen and Mason?

(Testimony of Ross B. Hammond.)

Q. No, Exhibits No. 2 and No. 3 are the bill of sale and partnership agreements.

A. Yes.

Q. Those are the discussions that culminated in those two instruments? A. Yes.

Q. Just before he went into the Army the first time, will you state the character of work he was doing at that time in connection with your operations?

A. I believe he was the engineer on the Aluminum Plant at Troutdale, in charge of all of the layout and general engineering of that type for all the buildings, which covered quite a territory and he had quite a few engineers under him.

Q. Will you state how the character of the work you were doing after the war started compared with the jobs that you were doing before, in Portland?

A. Well, the jobs were larger and there were many more of them.

Q. In connection with this aluminum job upon which Bill was the engineer, was he in sole charge of that job?

A. No. In fact, he was under Petersen, who was the superintendent in charge of the job.

Q. Who was the chief engineer? [90]

A. Bill was the chief engineer.

Q. And that was the condition when he went into the Army originally?

A. Yes, the first time.

Q. Then he was in there a short space of time and was discharged? A. Yes.

(Testimony of Ross B. Hammond.)

Q. When he came back, this partnership agreement was made? A. That is correct.

Q. What work did you set him to do? What was the nature of his activities after the partnership agreement was made? Were they enlarged any?

A. Very much. As a matter of fact, the conditions had changed into—We had got a big housing project, called University Homes, which took Mason out of the picture; took him clear out. That was one job that was plenty big enough. The activities at the aluminum plant had grown larger, and we had just accumulated another housing project at Guilds Lake. That left me with nobody in the office, so I made Bill general superintendent of the Guilds Lake project and also assistant to me in the office for other work.

Q. Were his responsibilities greatly increased by reason of that change?

A. Well, the Guilds Lake job was, I think, better than a million-and-a-half job of housing in which he was completely in charge and dealt with the Federal Public Housing Authority direct; took [91] care of the supervision of the construction, the collection of the money and the general records that are involved in that type of a transaction.

Q. Did he have anything to do with the making of the bids and submitting of the bids on that job?

A. Well, he helped; as a matter of fact, on a bid of that size, we all sit in, Peterson, Mason, Bill and myself, four of us.

(Testimony of Ross B. Hammond.)

Q. Who did the major part of accumulating the data and prices and so forth to enable a bid to be made?

A. I believe Bill did that on that job.

Q. Did he continue in doing work of that character after the partnership agreement was entered into? A. Oh, yes.

Q. Did he have authority to sign checks?

A. Yes.

Q. Did he have authority to give instructions with respect to the purchase of materials and to make decision with respect to the major aspects of the operation? A. Yes.

Q. How long, then, did he remain in that work before he again went into the Army?

A. I believe that was October of that year, 1942.

Q. Was there any difference of opinion between you and your son with respect to whether he should attempt to get into the Army or continue to work and so on? [92]

A. Yes, very much. I wanted him out of the Army because I believed he could do Uncle Sam more good here than he could in the Army and, after a lot of discussion, he practically told me to run my own business. He had been in the Army—he had two commissions and thought he ought to go.

Q. The operations you were conducting and the partnerships—and the contracts the partnership had, were they Government contracts?

A. I think 100 per cent of them were.

(Testimony of Ross B. Hammond.)

Q. It was your view that he could better serve the war effort by remaining with you?

Mr. Winter: All of counsel's questions are leading and we certainly object to them.

Mr. Bischoff: I will withdraw that question.

Q. State what your views were as to where he could best serve the war effort?

Mr. Winter: We will object to that as calling for a conclusion of the witness, what his views were.

The Court: Answer.

A. Well, he could best serve the same as Petersen and Mason and the rest of the boys were on this work that had to be done before the war started, actually.

Q. Your own knowledge of his physical disability, did that have anything to do with your determination or conclusion?

A. I knew they could never get him out of the country. [93]

Q. Do you know what the nature of his disabilities were?

A. Well, in layman's terms, he had had a mastoid, and they had severed a nerve, I think, and broke the eardrum, so he had a physical defect on the side of his face and he could not hear out of one ear.

Q. Nevertheless, he went into the Army in the latter part of 1942? A. That is correct.

Q. How long did he remain in the Army?

A. I think about four years.

(Testimony of Ross B. Hammond.)

Q. Do you remember when he got out of the Army?

A. I can't remember; about, oh, I think about two—I can add it up; a couple of years ago.

Q. Well, we will have Bill tell that. He will know perhaps better than you can recall it.

A. Yes.

Q. During the time he was in the Army did he go overseas at all? A. No.

Q. Was he discharged by reason of a disability ultimately? A. No.

Q. Did you see Bill at all during the period of time he was in the Army for the second time?

A. Several times.

Q. Did you confer with him in reference to your business affairs or partnership affairs? [94]

A. In detail.

Q. Did you correspond with him in connection with business affairs during the time he was in the Army?

A. Quite a lot, mostly by telephone.

Mr. Winter: This is all leading, it seems to me, if the Court please.

Mr. Bischoff: Q. Mr. Hammond, when you made the partnership agreement with your son in February, 1942, did you disclose the existence of that partnership agreement to anyone?

A. Only to Bill and——

Q. I presume your wife knew of it?

A. Yes. I very probably would do that.

(Testimony of Ross B. Hammond.)

Q. What did you continue to do in the matter of taking contracts for yourself?

A. I took them as an individual.

Q. Now, will you tell the Court why you kept the existence of the partnership between you and your son a secret?

A. Well, Mr. Mason, particularly, had been very aggressive in wanting more and more salary and an interest. I had been trying to satisfy them, and he wanted to be a partner. He wanted to have a proprietary interest in the organization which I definitely did not want. Mr. Petersen was less that way and——

Q. But was he wanting a partnership interest, too?

A. Yes, I think probably being led by Mr. Mason—a proprietary interest or some kind of a deal, either to form a corporation or [95] some way to get a proprietary interest, and we had been talking about it for a long time, a long time before these agreements ever crystallized. I did not dare let him know because, with all of this work coming up——

Q. Let who know?

A. I did not dare let Mason know or Petersen. After all, if you let anybody else know, you let everybody know, and, with all of this work that we had coming up, and with this type of men whom I had trained for ten or fifteen years, I knew, of course, the tendency was for every contractor to reach out and offer some enormous salaries to these

(Testimony of Ross B. Hammond.)

boys, and they were still boys, and I was afraid that they might jump at them.

But I didn't want to do that with Bill; if I was going to get him in, I wanted him in on a proprietary interest, which he agreed was the right thing to do, but I couldn't let them know that because immediately they would have put up a big argument and my agreement with them would have been worthless.

I couldn't tell the bank because Mr. Mason's father-in-law was vice president of the bank that I did business with, so I decided to tell nobody but Bill and his mother. That was the first reason, and then, when he went back in the Army a second time, then there were ten more reasons because he had had the same experience, as you may know, with the Government——

Q. Will you explain what those reasons were?
[96]

A. Every time you make a change order, with a partnership you have to have both signatures and at that time we did not know where Bill might be, and there would have been delay and delay, and red tape and everything under the sun, and that was the reason it was kept that way while he——until after the big rush, the first big rush, was over.

Q. Did you disclose the partnership to your bonding company or to any representative of the bonding company with whom you did business?

A. I believe I told Mr. Thomas of Dooly &

(Testimony of Ross B. Hammond.)

Company who had been handling our bonds for years. I didn't even want to tell him, but I thought there might be some tough bonds coming up and I wanted to be in a position for them to bond us. Well, they never did develop so we never had to put up a bond on this work.

Q. When you disclosed that to Mr. Thomas, what did he tell you?

Mr. Winter: We will object to what Mr. Thomas told him as hearsay, as far as we are concerned.

Mr. Bischoff. Q. Where is Mr. Thomas now?

A. He is on a vacation, I believe.

Q. Do you know where he is?

A. I think in Palm Springs; I am not sure.

Q. Did you withhold the information from your office help, the bookkeeper, for instance?

A. I withheld it from everybody.

Q. Is that the reason why you took the contracts in your own [97] name?

A. I didn't understand.

Q. Are those the reasons you took contracts in your own name, after the partnership was formed?

A. I couldn't, because these contracts were accessible to everybody in the office, particularly these men whom I wanted to keep it away from, because they had to be available, and I had to serve as an individual party in them.

Q. In your contract with your son, the partnership contract, you made a provision for retaining earnings above \$30,000 a year for working capital. Why was that done?

(Testimony of Ross B. Hammond.)

A. In the contracting business it is very important that we have heavy liquid assets because of bonding capacity and because of finance charges—Well, normally, while we are supposed to get paid every month, by the time they come through it is two months or better, but the workmen get paid every payday, and that requires a lot of cash or liquid assets which you can borrow money on at the bank.

Q. At the same time you made the agreement, the partnership agreement, with Bill, you also made two other agreements with Mason and Petersen? A. I did.

Q. Were similar provisions made with respect to retaining the working capital in the business?

A. Yes. I gave them a drawing account. [98]

Mr. Winter: The agreements are the best evidence, if the Court please.

Mr. Bischoff: Q. Mr. Hammond, during the course of the partnership arrangement, after the agreement was made, did you purchase some securities? A. Yes.

Q. With surplus funds? A. Yes.

Q. You bought them from time to time?

A. Yes.

Q. In whose name were those securities purchased? A. Mine.

Q. Were those purchased with firm's funds?

A. Yes.

Q. Why did you purchase those securities in your own name?

(Testimony of Ross B. Hammond.)

A. Well, I purchased them through Dickinson & Jones, bond brokers, and Mr. Jones, when I suggested what I wanted them for and why I was purchasing them—I, of course, wanted to purchase them as a partnership deal and he advised me——

Mr. Winter: We will object to what Mr. Jones advised him, as hearsay.

Mr. Bischoff: Yes.

Q. Were you buying and selling these securities from time to time? A. Yes. [99]

Q. In making sales, you knew you had to endorse the securities? A. Yes.

Q. And did the absence of your son in the service have anything to do with determining how to purchase the securities?

Mr. Winter: We submit that the question is leading and calling for a suggestion—a suggested answer. He can ask him his reason for doing it, but I don't think he can tell him the answer. The question is objected to.

The Court: Why did you buy them in your own name?

A. Because, in transferring them back and forth, as Jones suggested we might have to sell, and, to get the endorsement of Bill, when we would not know where Bill might be and how quick it could be obtained—it would be much simpler to buy them as an individual.

Mr. Bischoff: Q. Did you use these securities as collateral in financing?

(Testimony of Ross B. Hammond.)

A. The bank has \$50,000 of them now. The bank probably would not accept them unless they were endorsed by both.

Q. In other words, if they had been bought in the name of both, it would require the endorsement of both to use them for collateral? A. Yes.

Q. When, for the first time, was any disclosure made of the existence of a partnership between yourself and Bill to anyone outside of the immediate family?

A. When Bill came back from the Army, it was necessary, for [100] some reason, to establish the assumed name, to be published, and, knowing that that was going to be, I told Mr. Petersen. First, I told him and told Mr. Mason a little later on. This was only a couple of years ago.

Q. At that time what was the condition of affairs with respect to the need for secrecy?

A. Well, we were in a lot easier shape to take care of our business. We had developed some more men that could probably be brought up and Bill was back and, well, it wasn't so important whether somebody got mad and walked out.

Q. When you made the disclosure to Petersen, did he express any surprise?

A. Yes. His nationality keeps him from talking very much, being Swede, but he was rather surprised.

Q. Did you tell him the reason why you had kept this a secret from him? A. Yes.

Q. Did he make any issue of the thing after that? A. No.

(Testimony of Ross B. Hammond.)

Q. Did you ultimately inform Mason about it?

A. Yes.

Q. Had you communicated that information to him before you filed the assumed name certificate?

A. I think a short time.

Q. Up to the time that you made the disclosure of the existence [101] of a partnership between you and your son, did you give any instructions about changing the method of bookkeeping that had been theretofore used? A. No.

Q. After the disclosure was made, were any changes made in the bookkeeping so as to reflect his interest?

A. No, there was no changes made, that I know of.

Q. Mr. Hammond, may I ask to what extent, if any, you are familiar with the bookkeeping or accounting methods? Do you know anything about that at all? A. Very little.

Q. Have you had any training in that at all?

A. None.

Q. Do you profess to understand anything about accounting methods?

A. I have difficulty reading a financial statement.

Q. Did you give any detailed instructions as to the manner in which the accounts were to be kept? A. None.

Q. Whom did you leave that to?

A. My office manager and my counsel, Mr. Jacob.

(Testimony of Ross B. Hammond.)

Q. And your bookkeeper? A. Yes.

Q. Could you state, generally, how contracting work is done? That is, state generally how you make bids on the contracts and [102] how they are operated?

A. Well, normally, we get a set of plans, figure the quantities and prices, put a price on the cost of doing business, doing the job, and bid on it and, if we are the successful bidder, we make a contract to complete the job on that basis, usually through an architect who represents the owner. Does that answer your question?

Q. That is all right as far as it goes, but I wanted to know: Is there more than one type of construction contract? Do you take them on a fixed amount or are there some that you take on a cost-plus basis?

A. There are many different types.

Q. Generally speaking, what types of contracts did you make during these years in question?

A. Well, we had some lump-sum contracts; we had some cost-plus percentage contracts, which is a percentage of the cost; we had some cost-plus-fixed-fee contracts, which is the cost of the operation plus a fixed amount of money which you are paid for doing it.

Q. Were those three——

A. I beg your pardon?

Q. Were those three methods the ones that were employed in the contracts that you took?

A. Normally, yes. We had one that was entirely different.

(Testimony of Ross B. Hammond.)

Q. What was this one you speak of that was entirely different? [103]

A. This was the Aluminum Company job at Troutdale.

Q. State what happened? First, let me ask you: Who was erecting the Aluminum Plant? For whom was it being done?

A. The Defense Plant Corporation, with the Aluminum Company of America as their agent.

Q. Is that a Federal agency?

A. The Defense Plant Corporation was a subsidiary of the Reconstruction Finance Corporation.

Q. It was, in effect, a Government operation?

A. Yes.

Q. State what happened in connection with that project from its inception?

Mr. Winter: Was the contract in writing?

Mr. Bischoff: No, it was not, at the beginning. I want the history of the transaction, leading up to the ultimate making of a contract.

Mr. Winter: We will object to that. The contract is the best evidence. The negotiations leading up to it would be incompetent, irrelevant and immaterial.

The Court: Go ahead.

A. Well, apparently they had no preconceived idea of what they were going to build at Troutdale, but they had to have some competitive bids.

Mr. Bischoff: When you say "they," whom are you referring to? [104]

A. The Defense Plant Corporation.

(Testimony of Ross B. Hammond.)

Q. And its representative?

A. Yes, the Aluminum Company of America. How many contractors they called I don't know, but they eventually called us to give them a price per cubic yard on concrete, including the excavating, the forms, the concrete, the steel, anchor bolts and engineering and overhead; and they couldn't tell us how much concrete was going to be used. They gave us a few prints, some prints, some buildings that were over at Vancouver, Washington, and some way down South, and in Mississippi. They were going to have some buildings like them. They wanted a price per cubic yard on the concrete to build them.

Q. This price-per-yard basis, was that to include all the steel and everything else?

A. Everything.

Q. That was the yardstick that was to be used for computing the compensation?

A. That is correct.

Q. Proceed from there.

A. Then we finally agreed on that price per yard. That is all we had, was a price per yard.

Q. At the time when you agreed as to the price per yard, did you have any information as to how much yardage you were going to have to do on the project?

A. We had a guess verbally by the man in charge of the project [105] for the Aluminum Company.

(Testimony of Ross B. Hammond.)

Q. Does the quantity of work that is to be done have a bearing upon the yardage price that is to be charged?

A. Very much. It takes the same amount of equipment, it takes the same amount of engineering, it takes the same amount of overhead to put 10,000 yards of concrete in or 50,000 yards. The only thing, it takes more quantity of material to put in 50,000 yards, and perhaps a little more time, but the same equipment that we had to buy to put the 10,000 yards would put in 50,000 or 60,000, so we were trying to find out—there wasn't any way of finding out definitely how much concrete that we were eventually going to put in.

Q. Was there any rough estimate made at that time as to what it might be?

A. Yes. The man in charge guessed that there might be 30,000 yards. We looked at it and we thought that there would be 15,000 yards, so we compromised and based our price in between. As a matter of fact, when we ended up there were 60,000 yards.

Q. How much? A. 60,000.

Q. 60,000 yards? A. Yes.

Q. How did that increase come about? What was the reason for that large increase?

A. They added more and additional buildings as they went along. [106] Sometimes the style and type were changed and, of course, the unit price per yard of concrete would not always apply, and we had to go on the assumption that we were going to be treated fairly and, on the statement of the man in charge, we kept pouring concrete, but we

(Testimony of Ross B. Hammond.)

didn't have any contract to pour the concrete.

Q. Did you have any writing at all when you started in to do that work?

A. When we started the first operation, I think we had a letter agreement of so much a yard for the concrete that we were going to put in, based on a few sketches of the job, the building that we were going to build but, before we got through, everything changed, and they put up a different type of building.

Q. But, ultimately, you did get a written contract covering that job?

Mr. Winter: He said he had a letter contract, whatever that is.

The Court: Did you have a contract?

A. Eventually, we had a purchase order.

Mr. Bischoff: Q. Before you had that purchase order, was there any way of knowing how much concrete you had to pour or how large a building you would ultimately have to construct?

A. No.

Q. Were you able at this point to estimate the profits you were going to make on that operation?
[107]

A. No, we couldn't find out how much we were going to get paid for it.

Q. In what year did this originate?

A. The Aluminum Plant?

Q. Yes.

A. Well, 1942, I believe, in the early part of 1942.

(Testimony of Ross B. Hammond.)

Q. Was it 1941?

A. Well, it could have been the latter part of 1941. It is quite a while ago.

Q. At any rate, did you get a written contract in the same year the work originated or did you get it during subsequent years?

A. I can't recall. We probably started out there before we had any thing written. It was speed, speed and more speed.

Q. Who urged you to get started without any contract?

A. The representative of the Aluminum Company.

Q. Did the war conditions have anything to do with your determination to go ahead without a contract?

A. Well, we were also patriotic besides being businessmen and we knew that eventually we were going to get paid. We had to win the war or it would not make any difference.

Q. Was that the only instance of that kind, in contract work that you did during the years from 1941 to 1944, that type of contract?

A. Never had a type like that before or since, in the thirty-seven years I have been in the business. [108]

Q. With respect to the three other types of contracts, one being a lump-sum contract in which you took all the chances——

A. Yes.

(Testimony of Ross B. Hammond.)

Q. —and another, the cost-plus contract where your profit was figured on a percentage of the cost— A. Yes.

Q. —and the third was a lump-sum contract, regardless of the cost? A. Yes.

Q. That is, you were reimbursed your actual cost plus a fixed sum for your services?

A. That is right.

Q. Was the method of payment the same in all of those contracts, that is, the interim payments or payments during the course of the work?

A. No, they could not be.

Q. How frequently were you paid on these contracts, weekly or monthly? A. Monthly.

Q. How did you determine the amount for which you were to send bills each month?

A. On the normal type contracts?

Q. Yes.

A. Well, we would put in a bill to the architect who, in turn, checked the bill and issued a certificate to us, which we would [109] send to the owner and which the owner honored with payment. That was the normal procedure.

Q. How was the quantity or the amount for which you rendered bills arrived at? What are those called in contractor's words?

A. Monthly estimates.

Q. How were those monthly estimates arrived at which were included in each month's billing?

A. Our staff, one of them—Bill or Petersen or Mason or myself—would figure out how much we

(Testimony of Ross B. Hammond.)

had done on a certain job; take it up to the architect and go over it with him. If he agreed with us, that was it, and we put on a formal request which he approved and attached his certificate of payment, which we presented to the owners.

Q. Was that uniform practice?

A. That was normal practice.

Q. I would assume on each job the one who was superintending the work prepared those estimates?

A. Yes, if it was a large job,—if it was a job where we had somebody in charge of it that was big enough to do it.

Q. In other words, if Mr. Mason was in charge of the job, he kept the estimates and did those things you have described? A. Yes.

Q. If Bill was in charge, he did that?

A. Yes.

Q. So, he followed the normal way of doing it? [110]

A. That was the normal procedure.

Q. And that was the way it was followed out?

A. Yes, and then, of course, we checked the invoices which were at the office and not at the job.

Q. But in any event, before the invoices were submitted, the approval of the architect or engineer, or whoever was in charge for the owner, was obtained? A. That is right.

The Court: I think we had better break off now. You are getting into another subject.

Mr. Bischoff: Yes.

The Court: What time do you want to resume?

(Testimony of Ross B. Hammond.)

Mr. Bischoff: Two o'clock.

Mr. Winter: I would like to commence at one-thirty, if the Court please.

The Court: We are certain not to get through today.

Mr. Bischoff: I would prefer two o'clock, your Honor.

The Court: Two o'clock, then.

(Thereupon a recess was taken until 2:00 o'clock p. m.) [111]

Court reconvened at 2:00 o'clock p. m., Tuesday, January 13, 1948.

ROSS B. HAMMOND

plaintiff, having been previously duly sworn, resumed the stand and further testified as follows:

Direct Examination—(continued)

By Mr. Bischoff:

Q. Mr. Hammond, I was asking you about the method of making your monthly estimates to the owners at the end of each month, and you explained how that was done, in one instance.

With respect to the other three methods, that is, the fixed-amount contract where you take a contract for a lump sum and you take all the chances, and the contract, a cost-plus, percentage of the cost, and the third where you have the cost plus a fixed fee. How do you determine the monthly estimates in those three particulars?

A. Well, they are all determined approximately the same way, submitting the monthly estimate to

(Testimony of Ross B. Hammond.)

the architect who approves it and issues his certificate, which certificate we present to the owner for payment. They are all on practically the same basis.

Q. In the case of the Aluminum Plant job, did you submit any monthly estimates during the time you had no contract?

A. No, we couldn't. It was not recognized. We could not complete anything.

Q. In other words, you kept spending money for labor and [112] materials but you were in no position to bill them?

A. In the latter part of the job, yes.

Q. When you say "latter part", does that mean after you got your contract?

A. No. In the first part of the job, we would have the engineers on the job for the Aluminum Company with our engineers check the quantity of yardage which we had installed, which we had a unit price for, and that they would approve unofficially. Then we would make it out and send it through channels. It would go to the engineer who had already checked it, who would send it through to the main office; then, in turn, it went to the Aluminum Company, Pittsburgh office, then to the Defense Plant Corporation, Cleveland office, and it was finally sent back to some other office and eventually we got a check for it; but there was more of the job that we were pouring concrete on for which we had no prices established, so all we could do then was to keep pouring concrete but

(Testimony of Ross B. Hammond.)

we could not submit an estimate because there wasn't any order to check the estimate with.

Q. And, not being able to submit an estimate, you did not do any billing?

A. No. As a matter of fact, we did do some billing, and they sent it back to us saying we could not bill it.

Q. Do you remember when you concluded to dissolve the corporation and carry on your operations in your own name? You remember the occurrence? [113] A. Yes.

Q. Was the corporation dissolved at the end of 1937?

A. Approximately then, I remember.

Q. At that time, did you take up with your counsel and bookkeepers the matter of determining the method of accounting which you were to employ individually, after the dissolution of the corporation?

A. I think my bookkeeper took it up with me and said it was a very bad method to follow through, for several reasons. One was that I——

Q. The method that had been formerly used?

A. Yes.

Mr. Winter: We will object to what the bookkeeper told him as being heresay.

The Court: Go ahead.

A. Fortunately, I have to listen to my bookkeeper because I do not know much about bookkeeping.

(Testimony of Ross B. Hammond.)

Q. (Mr. Bischoff): As a result of her statement to you, did you take counsel and advice with respect to the method which should be employed?

A. Yes.

Q. Whom did you consult with?

A. I consulted with Mr. Jacob and my bookkeeper, who was very meticulous. While she wasn't a C.P.A., she was a very fine accountant. [114]

Q. You mean Mr. Jacob, who is counsel here in this case? A. That is right.

Q. Robert T. Jacob? A. That is correct.

Q. What was the name of the bookkeeper you had at that time?

A. Her name at that time was Edith Pack.

Q. Where is she now? A. New York City.

Q. When did she leave your employ?

A. I think it some time early in 1941.

Q. As a result of the consultations that you had as to the method of accounting that should be employed, did you come to some conclusion as to the method to be adopted?

A. Well, I was advised that the best method to use was the accrual method, and I hadn't any more idea of what that was than a rabbit, but I told them if that was the best method to use, let's get started.

There were some other things that entered into it, I remember, as I had been on a cash basis personally and I had accumulated a ranch, and I guess the ranch was a rather rough job on the accrual basis, and my bookkeeper attempted to check with

(Testimony of Ross B. Hammond.)

the Revenue Department to see if we couldn't keep that on the old basis and the construction business on the accrual basis, but they said "No," we would have to keep it all on one basis and, of course, the construction business being the larger, that [115] is what it was all kept under.

Q. Do you know why it is that the return, the tax return for the year 1938 was not made on the accrual basis?

A. Is that the last half of the Capitol Building?

Q. That is right.

A. Well, it was explained to me by my bookkeeper that in changing over—we had finished the contract, partially, on a basis—I think they call it a finished basis, but we were still—we still had some to complete when I did become an individual operator, and it was a confusing thing to know which to do.

I asked her, "Why don't you consult Jacob and possibly ask the Internal Revenue Department? It is something that has to be done," and, to the best of my memory, the information that she got was from the Internal Revenue Agent someplace that it should be carried on, that particular job, to make it consistent. That was her answer to me.

Q. The return, then, was made in the same manner as the corporation had reported earlier?

Mr. Winter: The return is the best evidence.

Q. (Mr. Bischoff): I am asking him.

A. To the best of my knowledge, yes.

(Testimony of Ross B. Hammond.)

Q. At any rate, an attempt was made to conform to it?

A. Yes, I presume so. I told her to do it.

Q. Mr. Hammond, what was your policy with respect to billing the owners for work? Was it the desire to get all the billing in [116] that you could?

A. Very much so.

Q. Why was that?

A. We needed the money. We billed as much as we could bill.

Q. You say "as much." You mean as much as you put into the contract?

A. All that we could bill legally, we would bill.

Q. Did that prevail all through the years?

A. All contracts.

Q. After Miss Pack left your employ, who became your bookkeeper?

A. She had had an assistant there who carried on for a short period; I think eight or nine months. But she was very definitely not going to stay because she was going to get married. We knew that. We wanted to find somebody that would be as permanent as possible, so—I don't remember her name even.

Q. You mean the assistant carried on for a while?

A. Carried on for a little while. I don't remember. It was not very long.

Q. After that, who became the permanent bookkeeper in you reestablishment?

A. Our present bookkeeper, Miss Novak.

(Testimony of Ross B. Hammond.)

Q. When did she start?

A. Some time early in 1942, the very early part of January or February.

Q. I call your attention to the fact that the contract, the [117] partnership agreement, was made February 3, 1942. Would that refresh your recollection as to when Miss Novak began?

A. She was there then. How long before that I don't know; it might have been a week; it might have been two weeks.

Q. At any rate, it was a very short period of time? A. It was a very short time.

Q. She has kept the books ever since?

A. That is correct.

Q. Did you inform her about the partnership agreement when you made it? A. No.

Q. At the end of the year 1942, or when it came time to make the income tax return for the year 1942, which would be along in the early part of 1943, did you inform Miss Novak, the bookkeeper, as to the partnership arrangement that had been made with your son? A. No.

Q. What, if anything, did you tell her to do with respect to your son's compensation?

A. Well, as I remember, I told her Bill was going to share in the profits after Petersen and Mason were taken care of in their agreements.

Q. Did you tell her to what extent he would share in the profits?

A. I told her it was about the same as Petersen's.

(Testimony of Ross B. Hammond.)

Q. Do you know whether she made entries accordingly?

A. I don't know. I never did see any entries.

Q. But you finally did tell Miss Novak about the partnership agreement?

A. I think Mr. Jacob called it to my attention in the first place that this return was not correctly made and, of course, then it was necessary to tell Miss Novak how it should be made and, in order to tell her that, I then told her about the partnership arrangement and, as I remember, I explained to her then why it had not been told to her previously and why it was essential that it be kept very confidential.

Q. Did you instruct her at that time to adjust the entries on the books to conform to the partnership relationship?

A. I told her to consult with Mr. Jacob and to be sure that the returns were properly taken care of, to correct the situation in whatever way it needed to be corrected.

Q. Mr. Hammond, in the opening statement of counsel for the defendant some mention was made about some figures with respect to the Troutdale Aluminum Plant. He pointed out that in the Troutdale Aluminum Plant contract, No. 208, that in 1941 the records show an accrual of income of \$59,775.31 and a profit of——

Mr. Winter: Mr. Bischoff, I have a typewritten copy that I might loan to the Court if the Court would like to follow it.

(Testimony of Ross B. Hammond.)

Mr. Bischoff: Yes, I would like the Court to follow it.

Mr. Winter: I think it is correct.

Mr. Bischoff: Your Honor will find about the center of the [119] page the title "Troutdale Aluminum Plant" and the figure "208" after it.

Q. He pointed out that, according to your books, you had an income of \$59,775.31 in 1941 from that job, and that your books showed a profit of \$23,544.42—Your Honor will find that at the end of that column.

Can you explain why so much credit was made in that year on that job? A. Yes.

Q. Will you, please?

A. When we went out there, just after we took over the contract, they changed the setup and there was a lot of clearing to be done, and we figured the price with all of the things that we thought might happen on that clearing, and it was going to be plenty tough.

Q. What clearing would have to be done? What was the nature of the terrain and what would have to be done as conditions existed at that time?

A. At that time it was pretty well soaked; it was low; it was just above the water line, and we figured putting in heavy equipment and so forth and clearing this was going to be a very costly thing, and they insisted—this was aside from any contract or any agreement that we had, an entirely new thing, and they wanted a lump-sum price on it.

Q. Let me interrupt a moment. Was this some-

(Testimony of Ross B. Hammond.)

thing different from [120] the construction of the buildings? A. Yes.

Q. Something independent?

A. Something that came up afterwards.

Q. Very well. Continue.

A. So we gave them a lump-sum price for that, which they insisted upon, and none of the things, of course, happened that we thought were going to happen, with the result that we did take over the job and made a tremendous amount of profit.

Q. The thing that you did not have to do was what? A. Clearing.

Q. Yes. Was there any filling done there by the Aluminum Plant?

A. The Aluminum Company decided to pump six feet of sand out of the river, which had never been contemplated at all before.

Q. Did they do that work?

A. They did the work themselves.

Q. What effect did that have upon the cost of operation to you?

A. Eliminated most of it.

Q. And resulted in a profitable operation?

A. A very profitable operation.

Q. It was pointed out also by Mr. Winter in that statement, with respect to the same job, in the year 1942, your books show that you received an income in the sum of \$1,036,623.16 and that your total costs during that year were \$1,057,459.83, with a loss in that year on that job of \$20,786.73.

Will you explain why, in that year, this operation showed a loss?

(Testimony of Ross B. Hammond.)

A. Most of it was because of our inability to bill most of the work.

Q. That was the job you have explained before where you did it without any contract?

A. That is right.

Q. In the following year you were able to bill for all the work?

A. Finally we got a purchase order for most of this work we had done in the latter half, at least, of the year before.

Q. And the ultimate profit was reflected in the following year, then?

A. That is correct.

Q. That is, it showed in 1943 an income of \$274,431.59, with a total cost of \$180,494.97, or a profit at the end of that year of \$93,986.62.

A. That is correct.

Mr. Bischoff: You may cross-examine.

Cross-Examination

By Mr. Winter:

Q. Just refer, Mr. Hammond, to Contract 207. You will notice the income per books is \$7,634.09 for 1943. A. 1943.

Q. \$7,634.09 for 1943. Do you notice that?

A. Yes. [122]

Q. With a total cost of only \$575.12, and you show a profit from these books of \$7,058.97.

Will you explain that distortion to the Court?

A. Yes.

Mr. Bischoff: Wait a minute. I object to the use of the term "distortion" as counsel's conclusion.

The Court: Well, I have been here a long time now and I have my own vocabulary.

(Testimony of Ross B. Hammond.)

Mr. Bischoff: You may answer, the Court said.

A. Yes. After we had completed, or thought we had completed, the Milwaukie Housing Project, the architect would not issue a certificate for all the money that was in our contract, which was a lump-sum contract, because he stated, or at least contended the owners stated, that we had not finished some work in the playground on which they held up some \$7,500 and which we could not bill because they would not give us a certificate, but later in the year we finally agreed with the architect and the Milwaukie Housing Board, I think it was, that if we did certain things to the playground that they would then issue a certificate for the full amount of the contract.

Q. (Mr. Winter): However, you content——

Mr. Bischoff: Let him finish.

Mr. Winter: I thought he had finished.

A. But the additional work we had to do to the playground was a very small amount of work, which is reflected in what it cost [123] us, so our cost was immaterial, but the money was the balance of the payment on the job which we could not bill because we could not get the architect's certificate.

Q. Therefore, the cost to earn the income of \$7,634.09 is necessarily reflected in either 1942 or 1944, isn't that true?

A. No, it is reflected in that last year.

Q. In 1944?

A. When we finally got the certificate. What year was that? 1943, wasn't it?

(Testimony of Ross B. Hammond.)

Q. You had expended the necessary costs to complete that job in 1942, hadn't you?

A. As far as we were concerned, yes.

Q. As far as you were concerned? A. Yes.

Q. You could not bill it until 1943?

A. That is right, because we could not bill it until we got the architect's certificate.

Q. In other words, you had expended all the material and labor in 1942 to complete the job and the job was completed except for getting a certificate and your ability to bill it?

A. So far as we thought.

Q. Did you at any time, in either of these contracts in 1941 or 1942 or 1943, ever take an inventory of the stock pile of materials on hand at the end of the year? A. No. [124]

Mr. Bischoff: Wait a minute. That is objected to, may it please the Court, on the ground that there is no requirement in the Internal Revenue Law requiring an inventory in a contracting operation when the taxpayer is on an accrual basis.

The Court: What is your position about that?

Mr. Winter: Our position, if the Court please, is that under the regulations consideration must be given to stock piles of material on hand or work in progress at the end of the year.

Q. What is your authority?

Mr. Winter: Well, the statute and regulations, if the Court please. Section 29 of the regulations says, if the Court please, that there shall be deducted from such gross income all expenditures

(Testimony of Ross B. Hammond.)

made during the tax year on account of the contract, account to be taken of the materials on hand and supplies on hand at the beginning and end of the taxable year for use in connection with the work under the contract and not yet so applied. In other words, the regulation——

The Court: What did you read from?

Mr. Winter: The regulation.

Mr. Bischoff: Let's have the regulation.

Mr. Winter: I haven't got a copy of the regulations here, if the Court please, but certainly I believe on cross-examination we should be able to go into the question of what was actually done with respect to these contracts.

The Court: I have not stopped the cross-examination. I just [125] wanted to know the number of the regulation.

Mr. Winter: Of course, this question is very broad and very comprehensive. I expect to prove it, if the Court please.

The Court: I want the regulation, if you have it. You just read something. Where did that come from?

Mr. Winter: Notes I made in connection with the preparation of this case, if the Court please. I did not bring the regulations.

The Court: Mr. Bischoff says there is no such regulation.

Mr. Winter: I think I have got it here someplace.

The Court: I was looking at your pleadings on another subject. I find an amended answer but I

(Testimony of Ross B. Hammond.)

have not found an amended complaint. Is there an amended complaint, Mr. Bischoff?

Mr. Bischoff: No, your Honor. The amended answer was not permitted, your Honor.

The Court: Oh, yes. I have got my parties twisted. I am straightened out now. We might as well settle now, if we can, the difference between you. Mr. Bischoff says there is no regulation applicable to contractors to require them to take an annual inventory as a matter of accounting for tax purposes.

Mr. Winter: If the Court please, we do not agree with counsel that the contracts were reported on a strict accrual basis. As a matter of fact, I want to call your Honor's attention to the return for 1938.

The Court: I would like to find out where you were reading [126] from. Do you know what he read from, Mr. Bischoff?

Mr. Bischoff: No, I don't, your Honor. There is one regulation that we know of that deals with inventories and that is Section 42-3 of Regulation 111, which was in effect for a period of time from the end of December 31, 1941, and that provides—If your Honor wishes me to read it.

The Court: No. You can state it better.

Mr. Bischoff: It is limited to a merchandising operation, like a grocery store or something of that order.

The Court: Go ahead with your cross-examination, Mr. Winter.

(Testimony of Ross B. Hammond.)

Q. (Mr. Winter): Have you answered my question? I wish you would re-answer it.

The Court: Before you go any further: I see the complaint is pretty sketchy. You have not worked up a pre-trial order in this case. I don't know whether you will be able to or not, from what the Clerk tells me.

Paragraph VI of the complaint says: "That said deficiency assessment and collection was illegal in that defendant refused to recognize the partnership entity of the Ross B. Hammond Company, and made arbitrary re-allocations of income."

Am I to understand that those things are not to be read together, that the defendant refused to recognize the partnership entity, for one thing, and made arbitrary re-allocations of income?

Mr. Bischoff: Is your Honor directing the inquiry to me?

The Court: That is your complaint I was reading from. [127]

Mr. Bischoff: There are two issues in the case, one the existence or non-existence of a partnership. That is a distinct issue which will affect the computation and——

The Court: You notice the allegation, that it is illegal in that defendant refused to recognize the partnership entity and made arbitrary reallocations of income. Does that latter clause "and made arbitrary reallocations of income" stand as an independent clause?

(Testimony of Ross B. Hammond.)

Mr. Bischoff: It is an independent clause, and that relates to the reallocation which was made of the income to different years, taking the income out of 1941 and putting it into 1942 and taking it out of 1943 and putting it into 1942.

The Court: Go ahead, Mr. Winter.

Mr. Bischoff: If I may add one further observation to clarify the issue: When your Honor sees these Revenue Agent's reports you will see that there is no issue of any kind tendered about the figures or the amount of income accrued. The sole question that is raised by his report, when your Honor reads it all through, will be whether we should have taken the whole of that accrual in each year or only a percentage of it. It involves a question of accounting methods. It also involves a legal interpretation of the term "clearly reflect the income."

Mr. Winter: Of course, it is the Government's position that the burden is on the plaintiff to show that he has overpaid this tax. They just cannot single out one thing and say that they [128] have done all that they have got to do, that they have taken the correct deduction and that they have overpaid their tax. The Court refused to allow us to file an amended answer so we could set that forth more in detail, but the burden is on the plaintiff to show that he has overpaid his income tax before he can recover in this action.

One of the defenses which we are setting up is that he took an unallowable deduction on his in-

(Testimony of Ross B. Hammond.)

dividual return by accruing the salary paid to Mason and Petersen which had not, in fact, accrued on his accrual basis of accounting.

Mr. Bischoff: There is no obligation on our part to put in any evidence concerning facts which are conceded by the Commissioner. The official Revenue Agent's report, which is the basis of this assessment, is in evidence, and it discloses the adoption of certain facts about which there is no dispute, and we did not have to put in evidence concerning the adoption of our figures, and the extent to which they were used.

The Court: Does the report criticize the fact that inventories were not taken?

Mr. Bischoff: Yes. I do not think he uses the term "inventory." If I recall correctly, I think he uses the term "work in progress," which is, in a sense, the same as inventory. I would not want to say with absolute certainty that he does not use the word, but I do not have any recollection of him using the word "inventory," but he criticizes the failure to [129] have an account which shows the work in process, and our position is that neither inventory or work in progress is essential to an accrual method for a contractor, because it does not reflect anything which we could show in the income tax return.

The law says that we can only take as income whatever moneys we have a right to receive. That is the limit of what we can do. We may have spent a great deal more, but if that is all we can do, that is all we can set up.

(Testimony of Ross B. Hammond.)

Just as Mr. Hammond pointed out with respect to this last item. He thought he was entitled to that \$7,500 but they would not pay it. They refused to certify it, so he could not bill for it, and it could not be accrued. The next year, he spent \$500 to do something and then they agreed to pay it, so he accrued it in that year, and that is what the law requires. We are bound to accrue everything for which we incurred liability. If we do not do it in that particular year, we cannot do it in a subsequent year, even though we pay it in the next year. It is not a matter of our choice. That is what the law tells us to do.

The Court: All right. Proceed.

Q. (Mr. Winter): Mr. Hammond, will you refer to Job 213, appearing on page 19 of the report?

A. What number?

Q. Contract 213, the Columbia Steel Casting Plant. A. Yes. [130]

Q. I notice that you report on your return income received from that job for the year 1943 of \$375,430.50. A. Yes.

Q. But a profit of only \$10,159.76. Was there a good deal of work in progress or material on hand at the end of that year?

Mr. Bischoff: That is objected to on the same ground, your Honor, involving——

Q. (Mr. Winter): That you could not bill for?

Mr. Bischoff: Just a minute until I get through, please.

The Court: Admitted, subject to the objection.

(Testimony of Ross B. Hammond.)

A. I am not familiar with the details of that job, but I would presume that it was in the same category, because the accounting was done on the same basis. I never attempted to go into the books.

Q. (Mr. Winter): You never attempted to estimate any work in progress for which you could not bill at the end of the year?

A. The only way I could answer that is that we attempted to bill everything that we had authorization from the architect to bill to the owner. All of our authorization came through the architect or engineer. That was another Defense Plant Corporation operation.

Q. In any construction project there is a considerable amount of work at the end of the year for which you cannot bill?

A. Normally, yes.

Q. In these large contracts you have to maintain a substantial [131] stock pile of materials, so that your work won't be stopped, is that right?

Mr. Bischoff: I wish to make an objection at this time. I will ask the Court that our objection may be deemed to go to any other questions that may be asked along the line of the question of work in progress or the question of an inventory.

The Court: Yes.

(Question read.)

A. No, that is not necessarily the fact. Some of them have a stock pile; some of them have not. It depends on the particular job. On some jobs we have practically nothing that is not in the work. On some jobs we may happen to get a couple of carloads

(Testimony of Ross B. Hammond.)

of cement or a couple of carloads of steel that we may not be able to bill, but it is charged to the job, as a rule.

Q. (Mr. Winter): In some contracts, of course, they only permit you to bill 75 or 80 per cent of work completed, the amount of work completed, is that right?

A. That is mostly true in a lump-sum contract.

Q. Then, the 20 per cent would, therefore, be postponed for billing until the next year?

A. I presume so. I don't know.

Q. In other words, would you say that was the reason why you show an income of \$375,430.50 and only a profit of \$10,159.76 in that year, whereas you only have income received of \$35,139.81 in 1944 and you show a profit of \$27,610.51, is that right? [132]

A. I can't answer that question. I don't know enough about the facts of that particular job to answer your question intelligently.

Q. You don't know what was accrued or what was not accrued?

A. No, I never had anything to do with the books.

Q. So far as you know, did anyone under your supervision, in your jurisdiction, take an inventory of stock-piled materials or work in progress for which you could not bill at the end of the year?

A. As far as I know, we never used what you apparently term an inventory. However, the material that is bought and sent to a job, and for which we have received a bill and for which we are liable, is charged to the job.

(Testimony of Ross B. Hammond.)

Q. Even if that material was to be used in a subsequent year, it would still be charged?

A. It would still be charged to the job when it was billed, to the best of my knowledge.

Q. Job 213 shows that you had over \$400,000 income. No. That job was completed in 1944, I presume.

Mr. Bischoff: What job are you talking about?

A. Apparently.

Mr. Winter: Contract No. 213 is the one we are talking about.

A. Apparently; it says 1944.

Q. Contract 215, Northwestern Ice Company: You have an income received of \$51,583.98 and you show no net profit reported. [133]

A. If I remember that job correctly, that was another one of these Defense Plant Corporation jobs. That was a Defense Plant Corporation job, the same as the Columbia Steel Casting Company and the Aluminum Company.

Q. Do you consider you did not have any income in 1943 from Contract No. 215?

A. In earnings from work?

Q. Or material?

A. According to our books.

Q. You did not have any?

A. Apparently not, not from this.

Q. But you operated at a profit on substantially all of your contracts?

A. We hoped to, but there was quite a few that we never knew whether we were going to until we got them finished and a chance to bill them.

(Testimony of Ross B. Hammond.)

Q. Contract No. 217, on page 20.

A. Kaiser Reserve Warehouse.

Q. You have an income in 1943 of \$87,300.25 and costs of \$83,885.39, showing a profit of \$3,414.86. Is that right? A. Yes.

Q. And in 1944 your income from that job was \$110,397.75 and your costs, \$94,619.81. In other words, the costs are substantially the same as in 1943, but you have five times the profit in that year? [134]

A. Mr. Winter, that might happen on every job or any other job. It is a question of how you can bill it and what you have to charge against it. Sometimes these jobs show a much larger profit and sometimes they show a smaller profit. Some of these—As I remember, the Kaiser Reserve Warehouse was a lump-sum job.

Mr. Bischoff: You mean a lump-sum fee?

A. Guaranteed contract, yes.

Mr. Bischoff: Cost-plus-fixed fee, is that it?

A. No, a bid job in which we were low bidder, and we were going to do that much job for that much money. I am not sure of that.

Mr. Winter: I wonder if I might examine the witness without interruption?

Mr. Bischoff: I beg your pardon.

Q. (Mr. Winter): This Aluminum Company of America job, when did you secure that contract?

A. Some time in the latter part of 1941, as I remember it.

(Testimony of Ross B. Hammond.)

Q. I show you what has been marked and introduced in evidence, I take it—I show you Contract No. 208.

Mr. Bischoff: Marked for identification. It is a part of one exhibit.

Q. (Mr. Winter): That is the first contract you had with the Aluminum Company of America, that Contract 208, is that right?

A. I believe that is correct.

Q. What does that contract cover? First, when is the contract [135] dated?

A. November 15, 1941.

Q. Was that the time you entered into a contract with them?

A. That is right. It must be the time. That is when it is dated. We might have done a lot of things before that is actually dated.

Q. And that was a contract for what? What work?

A. This is the first part of the Troutdale Aluminum Plant for the Aluminum Company.

Q. Then you had two subsequent contracts with the Aluminum Company of America, did you not?

A. We had several. Whether there were two or more I don't know.

Q. One covering labor and materials and brick work?

A. Yes. This was different. This covers the concrete work that I explained before. The brick work was an additional contract.

Q. Did you have two contracts that you were working on out there in connection with the Trout-

(Testimony of Ross B. Hammond.)

dale Aluminum Plant? I mean two different jobs that you were working on at the same time, I mean in the same area?

A. Yes, it was all in the same area, in the area that was covered by the Defense Plant Corporation, the Aluminum Plant.

Q. I know, but in your records you more or less had Contract 208 and Contract 208-A that were started as one, is that right—considered as one for billing purposes?

A. What is 208-A? [136]

Q. Both are Troutdale Aluminum Plant contracts.

A. Yes. This is Amendatory Agreement No. 4, and it is apparently amendatory of that one because—Let me look at it a minute. This is something that had not been covered at all. It was brick paving and it could be that there was some brick walls in a building. I am not sure. Apparently not. This is apparently the only brick paving.

Q. In your income tax return for 1942, Plaintiff's Exhibit No. 6, the costs for 208 and 208-A were consolidated.

A. I guess I don't understand that question.

Q. In other words, you consolidated the costs and income from those two contracts, 208 and 208-A?

A. That could be. I don't know.

Q. In other words, all the material was out there, and no inventory was taken of that and still the costs are consolidated?

(Testimony of Ross B. Hammond.)

A. We didn't take any inventory; if they were delivered on the job, they were used on the job and presumably shown in the books.

Q. On a contract for a construction job, what is the practice about having material on hand?

A. This particular job, we hauled it from the Columbia Brick Works in a truck. We never had any particular material on hand that I know of, except for a day or two.

Q. Wouldn't you have to have steel on hand?

A. For brick work; we don't erect the steel.

Q. What? [137]

A. We don't erect the steel for a building. I think the one you are talking about was a paving contract.

Q. A paving contract?

A. Yes, 208-A, according to this.

Q. What is 208? What does that cover?

A. This is for the brick work on four or five different buildings, but the steel frame was erected by someone else. All we had, or all we did was to put up the bricks.

Q. All you had was the contract for the brick?

A. For the brick, yes.

Q. What is your explanation for the difference where you have \$1,036,623.10 of income and you have a loss of \$20,786.73?

A. I just explained that. We couldn't bill it because we had nothing to bill it on.

Q. What does that cost consist of, materials on hand and work partially completed?

A. Perhaps consisted of materials or work partially completed.

(Testimony of Ross B. Hammond.)

Q. What was your total profit on those two contracts? A. On what, 208 and 208-A?

Q. Yes.

Mr. Bischoff: You mean the total cost?

Mr. Winter: The total profit on those two contracts.

A. I think I will have to have some help. The profit from the books, \$96,694.31. That is on 208. The other one, 208-A, \$57,789.20. [137]

Q. When was that contract completed, Troutdale 208?

A. To the best of my knowledge, in 1944. I would have to get more information to be specific.

Q. It was in 1943, wasn't it, Mr. Hammond?

A. It could be.

Q. Most of the work in construction was done in 1942, when you expended \$1,057,409.83, isn't that right?

A. Well, according to this. If this is our return, we spent \$1,057,409.83 in 1942, plus \$200,000, more than \$200,000, roughly——

Mr. Bischoff: You are reading the wrong one.

Q. (Mr. Winter): You are reading the wrong one. Your total cost in 1941 was only \$36,230.89.

Mr. Bischoff: Go down further to "Total Costs" and read across.

A. \$36,230.89, \$1,057,409.83 and \$180,494.97, which shows the majority of it was done in 1942.

Q. (Mr. Winter): As a matter of fact, while it was approximately \$213,000 in 1941 and 1943, the total costs were nearly \$1,057,000 in 1943—1942, I should say.

(Testimony of Ross B. Hammond.)

A. 1941 and 1943 it shows about \$216,000 and in 1942, \$1,057,409.83.

Q. You paid all your employees salaries?

A. Yes.

Q. You were accruing all the billings for all material that was ordered during that year, whether it was included in the inventory or not? [139]

A. I don't quite understand.

Q. All your men were paid weekly, I think you explained? A. That is correct.

Q. All your other costs were accrued at the end of the year, regardless of whether or not you were able to bill for the material on a job or not?

A. If we had ordered the material, we charged it to the job, on our books.

Q. Regardless of whether you were permitted to accrue any billings for work to be done in the next year?

A. Well, according to our method, as far as I knew it, when we ordered it, it was a cost on the job; when we collected, it was an entirely different item.

Q. Mr. Hammond, let's go back to the partnership matter. You say prior to 1938 you operated as a corporation, is that right?

A. Pardon me?

Q. You operated your business as a corporation?

A. Yes, up to, I think——

Q. ——December 31, 1937?

A. I think that is correct.

Q. You were the sole stockholder of that corporation, were you? A. No.

(Testimony of Ross B. Hammond.)

Q. Except for qualifying shares?

A. Yes, except for qualifying shares.

Q. Your son was not a stockholder? [140]

A. No.

Q. He was in school in 1938? A. In 1938?

Q. Yes.

A. Yes, I believe he was at Stanford.

Q. I think you said he finished in——

A. ——'40, I believe, '40 or '39. I would have to check with him on that.

Q. Well, you had formed your corporation and at the time you dissolved the corporation you had the State Capitol contract?

A. Yes, it was in the process of erection.

Q. I think it was stated that you began in 1936 and you finished in 1939, is that right?

A. No, I think it was started either in the latter part of 1936 or early 1937 and we finished in 1938.

Q. Will you refer to your income tax return? Maybe I can save a little time here. Your 1938 return shows that it was 98-3/10ths complete in December 31, 1938?

A. Yes, I presume so.

Q. 1938 was the first year you operated individually? A. That is correct.

Q. Then, in 1939, you reported the balance of the profit not previously reported?

A. I haven't those figures here.

Q. Will you refer to the return? [141]

A. I presume if that is on the return, that is correct.

(Testimony of Ross B. Hammond.)

Q. You also report a portion of the contract completed with respect to Contract 196, with respect to the 1285 Barracks Building?

A. That could be, if it is on the report.

Q. When did you complete the 1285 Main Barracks Building, do you remember that? Look at your 1940 return.

A. No, unless you tell me when it was.

Q. Portion of contract completed in 1940, \$17,947.58, and you reported a profit of \$262.53?

A. If that is the United States Certificate, that is authentic.

Q. You were, in 1938, 1939 and 1940 reporting the portion of the building, the contract, that was completed?

A. Certainly, that is when we had certificates to show that it was that much completed. That certificate came from either the architect or the United States Engineer.

The Court: Take a short recess.

(Recess.)

Mr. Winter: Your Honor inquired about the status and regulations which the Government relies on. We rely on Section 41 of the Internal Revenue Code which provides: "The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of [142] accounting has been so employed, or if the method

(Testimony of Ross B. Hammond.)

employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income."

There are two methods of keeping books, the accrual method and the cash method. The taxpayer requested on his own personal return that he be allowed to follow the same method as used by the Corporation in keeping books upon an accrual method.

With respect to long-term contracts, the statute authorized two methods, one, the percentage-of-completion method and, the second, the finally-completed-and-accepted method. The statute provides "Persons whose income is derived in whole or in part from such contracts may, as to such income, prepare their returns upon either of the following bases:

"(a) Gross income derived from such contracts may be reported on the basis of percentage of completion. In such case there should accompany the return certificates of architects or engineers showing the percentage of completion during the taxable year of the entire work to be performed under the contract. There should be deducted from such gross income all expenditures made during the taxable year on account of the contract, account being taken of the material and supplies on hand at the beginning and end of the taxable period for use in connection with the work under the contract but not yet so applied."

(Testimony of Ross B. Hammond.)

In other words, if there was work in progress for which [143] they could not make a billing, in reporting a long-term contract, they can only accrue the percentage or amount which they have actually expended work upon and that they can bill for. Otherwise, the income is distorted.

With respect to the completed contract basis, the regulation also says "Taking into consideration any material and supplies charged to the work under the contract but remaining on hand at the time of completion."

The request of the plaintiff for permission to report is contained in Exhibit 28. Mr. Hammond requested, in accordance with Section 29.42-4, permission to change his method of accounting. That section provides: "A taxpayer may change his method of accounting to accord with Paragraph (a) or (b) of this section only after permission is secured from the Commissioner, as provided in 29.41-2."

In other words, he asks for permission to come under this section of the statute and says,—

"In accordance with the requirements of Article 42-4, Regulation 94, application is hereby made—"

Mr. Bischoff: What are you reading from?

Mr. Winter: I am reading from a letter of Mr. Hammond to the Commissioner. [144]

"—In accordance with requirements of Article 42-4, Regulations 94, application is hereby made for permission to account for profits upon contracts performed by this company, upon the basis of a percentage of contracts completed within each calendar year.

(Testimony of Ross B. Hammond.)

“Doubtless this request is not necessary as no change is being made in the accounting methods heretofore employed, but on December 21st, 1937, the corporation, Ross B. Hammond, Inc., was dissolved and the business transferred to Ross B. Hammond, the sole stockholder of the corporation. The first return, of course, covering the operation of the business as a sole proprietorship, will be for the year 1938, and, as we understand the regulations, the method used upon the first return is optional with the taxpayer. However, since there has been a change in the form of organization, it is desired to take every precaution possible to see that the method heretofore employed by the corporation is perpetuated and that the new ownership is permitted to file upon the same basis as that used by the corporation.

“In view of the fact that the corporation’s books had been kept on the accrual basis, the individual books would be kept on a similar basis and the returns made accordingly on the accrual basis.”

We are not talking about reporting for long-term contracts; we are talking here about keeping of the books.

The Commissioner came back and advised Mr. Hammond under [145] date of March 29, 1938, as follows:

“Reference is made to your letter dated March 3, 1938, in which you request permission to report your gross income for the calendar year 1938 from contracts upon the basis of a percentage of com-

(Testimony of Ross B. Hammond.)

pletion of such contracts in accordance with the provisions of Article 42-4, Regulations 94, which is the same method used by Ross B. Hammond, Inc., the assets and business of which were transferred to you as sole stockholder on December 31, 1937, and now being operated as a sole proprietorship. It is assumed that no income was received by you as an individual from long-term contracts prior to January 1, 1938.

“You are advised that to the extent that your income is derived from long-term contracts as defined in Article 42-4 of Regulations 94, you may report your gross income from such contracts upon either of the two bases set forth in that article of the regulations. Whichever method is adopted by you in your first return must be followed for subsequent years, unless permission to change such methods of accounting is obtained from the Commissioner as provided in Article 41-2 of Regulations 94.”

Mr. Hammond comes back as follows in his letter of April 5, 1938:

“On March 3rd, 1938, the writer addressed a letter to the Commissioner of Internal Revenue stating that Ross B. Hammond, Inc., a corporation, had been dissolved, and the business transferred to me, the sole stockholder. I requested permission to report income from contracts, as an individual, on a percentage of completion basis, as the corporation had previously been doing, and to keep all accounts and make all returns on an accrual basis. Your

(Testimony of Ross B. Hammond.)

reply of March 29th grants permission to me to report income from contracts as the corporation had been doing, but makes no statement [146] regarding keeping all accounts on an accrual basis.

“Up to the year 1938, Ross B. Hammond, Inc., a corporation, made all of their returns on an accrual basis, and Ross B. Hammond, as an individual, who kept no books, made all of his returns on a cash basis.

“The corporation has been dissolved, and all future returns will be made as an individual, and, since the main income of Ross B. Hammond is from the construction business which has been kept on an accrual basis, we, therefore, request definite permission to make all future returns of Ross B. Hammond as an individual on the same basis as the corporation had previously made returns, which is the accrual basis.”

In other words, prior to that time he had been keeping his accounts on a cash basis, and he wanted to come on the accrual basis, as the corporation had been, but still report, of course, long-term contracts on a percentage of completion basis.

It is our contention that he did not follow the regulations and it was necessary for the Commissioner to re-audit them and reallocate the income in accordance with the best method we have been able to devise. I think it is clearly evident the income is grossly distorted—no inventory, no work partially completed. This is the only method which could possibly be used, without that other information.

(Testimony of Ross B. Hammond.)

Mr. Hammond, under date of May 9, 1938, wrote the Commissioner:

“Replying to your letter dated April 25, 1938, regarding permission to change my method of reporting income from cash to the accrual basis, beginning with the taxable year 1938, please be advised that all items on my personal return for 1937 were reported upon the cash basis, hence:

“(a) There was no accrual of income not received;

“(b) No income received in advance of when earned;

“(c) No expenses accrued but not paid; and

“(d) No expenses prepaid.” [147]

Mr. Hammond then wrote and said there was no accrual of income not received and, in response, then, the Commissioner of course sent him a letter saying that he could report—he could keep his books on an accrual basis the same as the Corporation had been keeping them, but the returns indicate that they have not taken into account the things that are necessary.

The Court: Did you find the regulation you read from earlier in the afternoon?

Mr. Winter: I beg your pardon?

The Court: You read earlier from a regulation. Did you find what that was?

Mr. Winter: That is this regulation that I was talking about, your Honor.

The Court: A couple of hours ago you read from a piece of paper. Are you able to give us now the regulation that that was quoted from?

(Testimony of Ross B. Hammond.)

Mr. Winter: I am producing the regulation which I quoted from, yes, your Honor.

The Court: Are we talking about the same thing? A couple of hours ago you read from a piece of paper and you did not have the number of the regulation. What is the number of it?

Mr. Winter: The number of the regulation is Section 29.42-4, in Regulation 111.

The Court: Re-read now what you read then.

Mr. Winter: You mean from the piece of paper? [148]

The Court: I am not suggesting you misquoted it but I would like to have it re-read now in the light of what you have been saying. If it is not handy, that is all right. Do you want to add anything further, Mr. Bischoff?

Mr. Bischoff: Yes, your Honor. I want to clarify some things.

The Court: I will hear you now. Don't bother about that, Mr. Winter. It is not important.

Mr. Bischoff: May it please the Court, all the law governing the method of accounting that is imposed upon a taxpayer is included in Sections 41 to 48.

The Court: Before you go further, he has found the paper now, apparently.

Mr. Winter: "There should be deducted from such gross income all expenditures made during the taxable year on account of the contract, account being taken of the material and supplies on hand at the beginning of the taxable period for use in con-

(Testimony of Ross B. Hammond.)

nection with the work under the contract but not yet so supplied.”

The Court: That is from the regulation?

Mr. Winter: That is from Section 29.42-4, Regulation 111. Similar provisions have been in Regulation 94, Regulation 103 and prior regulations.

Mr. Bischoff: Your Honor will recall that provision that he read from the piece of paper, and he now directs attention to the regulation providing for the method of accounting when a [149] taxpayer is on an accrual basis. We are concerned here now with that.

Mr. Winter: I said he kept his accounts on an accrual basis.

Mr. Bischoff: Now, are you through now? If you want to say anything, say it because I want to get through myself.

We claim we are on an accrual basis. They challenge our assertion that we are on that basis or have a right to be on that basis, and he said that there was a regulation which compels us to keep certain definite accounts in order to demonstrate that we are on an accrual basis. That is the statement he made to your Honor. Then he started to read from the piece of paper which he said applied to an accrual basis. I will presently demonstrate to your Honor that that is not the law at all and it does not apply to an accrual basis.

Section 41 to 48 of the Internal Revenue Code comprise all the laws, the Act of Congress which prescribes and imposes on taxpayers duties with respect to methods of accounting.

(Testimony of Ross B. Hammond.)

They first give the taxpayer the option to adopt any method that he pleases, providing that it clearly reflects the income. That is Section 41 and is the section read to your Honor in the beginning. Then, the Commissioner, pursuant to authority of law, adopts regulations to supplement the provisions of the statute and, among other things, he adopts a regulation which provides for permissible methods of accounting. The [150] statute itself authorizes, in express language, cash or accrual. The Commissioner devises an additional two methods which are optional, not compulsory, and he lays down in the regulation what is needed when you exercise an option to adopt one of these optional methods.

He first deals in the regulation with the method of accounting. This is found in Regulation 29.41-3 which deals with methods of accounting, and that is the label of the section, "Methods of Accounting." That section says: "It is recognized that no uniform method of accounting can be prescribed for all taxpayers, and the law contemplates that each taxpayer shall adopt such forms and systems of accounting as are in his judgment best suited to his purpose. Each taxpayer is required to make a return on his true income. He must, therefore, maintain such accounting records as will enable him to do so."

Under the first subdivision of that paragraph it says: "In all cases in which the production, purchase or sale of merchandise of any kind is an income-producing factor, inventories of the merchan-

(Testimony of Ross B. Hammond.)

dis on hand (including finished goods, work in process, raw materials and supplies) should be taken at the beginning and end of the year and used in computing the net income of the year."

Obviously, this does not apply to a contractor who does not engage in buying and selling merchandise. The Commissioner recognizes in the ordinary mercantile operation that a [151] certain definite procedure is desirable and necessary and will be conducive to the production of a return that will reflect the income.

But, then, he goes on in the succeeding section and deals with the subject matter of long-term contracts, which is the thing we are concerned with here, and he says: "Income from long-term contracts is taxable for the period in which the income is determined, such determination depending upon the nature and terms of the particular contract. As used in this section, the term 'long-term contracts' means building, installation or construction contracts covering a period in excess of one year from the date of execution of the contract to the date on which the contract is finally completed and accepted. Persons whose income is derived in whole or in part from such contracts may, as to such income, prepare their returns upon either of the following bases," and then he sets forth under (a) and (b) two bases, one the percentage-of-completion and, the other, the completed-contract basis.

The regulation which he just told your Honor supports his contention that inventories and work-

(Testimony of Ross B. Hammond.)

in-progress accounts are essential to an accrual method is the statute or regulation that he read, and which applies solely to the adoption of a percentage-of-completion method. If we had done that in connection with our contracting business, we would have had to maintain our records as this regulation requires. That is what he [152] read to your Honor. This is one of the permissive methods in long-term contracts:

“Gross income derived from such contracts may be reported upon the basis of percentage of completion. In such case there should accompany the return certificate of architects or engineering showing the percentage of completion during the taxable year of the entire work to be performed under the contract. There should be deducted from such gross income all expenditures made during the taxable year on account of the contract, account being taken of the material and supplies on hand at the beginning and end of the taxable period for use in connection with the work under the contract not yet so applied.”

That is the requirement where we have elected to adopt the percentage-of-completion method. It was applicable to us in 1938 and in connection with the return in 1939 when we finished the State Capitol, but when we have elected the accrual method there is nothing in this regulation which imposes that kind of an accounting method, and the regulation that he read does not support that contention, nor support the idea that the Commis-

(Testimony of Ross B. Hammond.)

sioner—the very fact that the Commissioner saw fit to adopt a regulation of his own dealing with two specific types of taxpayers and providing specifically how they shall report, if they elect a certain method, carries with it the legal implication that as to all others this does not apply.

Then there is this second fact which I called to your [153] Honor's attention in opening, in this other regulation which he read and which I just concluded reading. It stops at the point where I have just stopped. In the prior regulations, added to this was the provision which authorized the Commissioner, at the end of the completion of a contract, after one, or two or three years, when you can ascertain the actual profit—the taxpayer could do it himself or the Commissioner could compel a recomputation of the whole operation in accordance with the profit which was determined upon completion; if the return did not clearly reflect the income for any year or years, the Commissioner might permit or require an amended return. In other words, it authorizes them to revise the whole thing and ignore the prior return and revise it, but that was eliminated. However, it is no longer permissible now, under any regulation, and, so, I say to your Honor that Mr. Winter has not demonstrated here that there is in existence any Act of Congress or any regulation promulgated by the Commissioner which imposes upon a contractor-taxpayer who adopts the accrual method to carry an account of inventory and to carry a work-in-progress account.

(Testimony of Ross B. Hammond.)

He is permitted and required to keep his accounts and report upon the basis which the law recognizes as applicable to that method, namely, accruing money that he is entitled to receive, and accruing liabilities that he has incurred in the year in which the accrual takes place. That is the situation we have here. [154]

Counsel read at length and rather hurriedly—I don't know whether your Honor could follow the import of the letters that he read, the letters that preceded the consent that was given to change the method of accounting. However, your Honor can read them for yourself and see what they contain, that series of letters which he read.

There was, apparently, a good deal of misunderstanding between the Commissioner and the taxpayer as to what the situation was, and that resulted in an exchange of these several letters. Your Honor will see, as soon as you read them, that the misunderstanding was clarified and that the Commissioner issued a letter of July 7, 1938, which reads:

“Reference is made to your letter dated May 9, 1938, submitting additional information in connection with your request for permission to change your method of reporting income from the cash to the accrual basis, beginning with the taxable year ending December 31, 1938.

“It is stated that at December 31, 1937, you had no accrual of income not received, no income received in advance of when earned, no expenses accrued but not paid, no expenses prepaid.

(Testimony of Ross B. Hammond.)

“It appears from the information submitted that there will be no duplicated or omitted items of income or deduction.

“Predicated on the foregoing, permission is hereby granted you to change your method of reporting income from the [155] cash to the accrual basis, beginning with the taxable year ending December 31, 1938.”

That was his final conclusion after the misunderstandings were clarified by the exchange of correspondence, the misunderstanding arising from this situation. The letter of Mr. Hammond's, when your Honor reads it, you will see, was written by a layman, not an attorney versed in income tax law or from a legal standpoint.

It called attention to the fact that the Corporation had started this State Capitol job and that the Corporation was being dissolved; that they had reported on a percentage basis for the Corporation and they wanted to report the balance of the operation in the year of completion on the same basis but, since Mr. Hammond was on the cash basis individually and they contemplated going on the accrual basis thereafter, they wanted permission to do that except for the year 1938.

That is all that correspondence does, when you take these letters all together. You will see, when your Honor reads all the correspondence, that the Commissioner's office did not quite understand the situation; it had not been made very clear in the first letter, and they exchanged two or three letters,

(Testimony of Ross B. Hammond.)

and it finally was clarified and it resulted in this permission being granted. That is all in the world that we have.

But, over and beyond that, assuming that they had never gotten any permission to report on the accrual basis, it has now [156] been definitely adjudicated by a decision that where a taxpayer has consistently reported on a given basis year in and year out for several years and the returns have been audited and have not been challenged, that will be deemed the equivalent of permission to use that basis of accounting, that method of accounting. In that connection, I call your Honor's attention to the case of *Fowler v. Commissioner of Internal Revenue*, 138 F. (2) 774, where the Court said:

“The requirement that a taxpayer, after electing to use a method of accounting in income tax, must follow such method in returns for subsequent years, unless permission is granted by the Commissioner to change to another method, may be satisfied by Commissioner's acceptance of returns which give notice to him that the method originally adopted has been changed, and the situation then stands as though Commissioner had given express permission to allow change in method of accounting.”

That is the situation here, regardless of all the quibbling there may be with respect to formal consent and the misunderstanding they had in their early correspondence. If we had nothing of that here, the Court would be bound, if it followed this decision, to say that this taxpayer, mistakenly or

(Testimony of Ross B. Hammond.)

otherwise, assumed he had a right to report on the accrual basis since 1939. He did so during 1939, 1940, 1941 and 1942. In all the years except one the Revenue Agent never challenged the right to proceed on an accrual basis, and, therefore, the Commissioner will be deemed to have consented.

Mr. Winter: Is it your contention that you had a different basis for 1938 than you had for 1942?

Mr. Bischoff: Our contention is that, beginning January, 1939, we were on the accrual basis; that we had a right to be on that basis; that we had permission to be on that basis; that we kept our accounts on that basis; made our returns on that basis.

Mr. Winter: What basis do you contend you were on for 1938?

Mr. Bischoff: I don't know. It doesn't make any difference what it was. Those years are not involved. We are concerned only with the years in controversy here.

The Court: Proceed, Gentlemen.

Q. (Mr. Winter): Mr. Hammond, I think you said you are not a bookkeeper and you have had very little experience in bookkeeping; that you are a contractor? A. That is correct.

Q. Are you familiar with income tax regulations? A. I probably never saw one.

Q. I show you what has been marked for identification as Pre-Trial Exhibit No. 28. Did you write that letter or did someone else write it for you?

(Testimony of Ross B. Hammond.)

A. Very probably it was dictated by my attorney.

Q. You mean Mr. Bob Jacob, counsel here? [158]

A. Mr. Bob Jacob, yes.

Q. The billings which have been marked for identification as Pre-Trial Exhibit No. 21, those are billings which were made by the contractor to the owner, your billings to the owner, is that right?

(Question read.)

Q. Is that right?

A. I presume so. They were billed on our letterhead.

Q. When you made the billings were the billings made on the percentage of the building which was completed as of the time of the billing?

A. Not necessarily. They were made on the authorized amounts that the architect or engineer permitted us to bill.

Q. In other words, on engineer's estimates as to the percentage of completion at the time of billing?

A. On estimates by the architect or engineer as to the amount of money we were entitled to.

Q. It was based on the percentage of the work?

A. That I couldn't say.

Q. It was based on the percentage of the money and materials you had expended in the contract, is that right?

Mr. Bischoff: The question is, in effect, calling for a conclusion.

Mr. Winter: This is cross-examination.

Mr. Bischoff: That does not authorize the witness to testify [159] about legal matters. There is a

(Testimony of Ross B. Hammond.)

question of interpretation as to what is meant by "percentage of completion." The Revenue Agent in his report makes quite an issue of that as to the percentage of the completion of the structure as a whole and percentage of completion of the component parts, and he says in his report the engineers only determined the percentage of completion of the component parts but did not determine the percentage of completion of the whole building, so there is a legal question as to what is meant by that term. The question as asked calls for a legal conclusion.

The Court: I think I know what a contractor can get. He can get whatever the engineer or architect allows him. They have some very funny ideas sometimes. All I can say is that I am not confused and I think I know what you gentlemen are disputing about now. Go ahead and ask your question again, Mr. Winter.

Q. (Mr. Winter): Mr. Hammond, is it not a fact that the billings were based upon the amount of work which had been completed and approved by the engineer as of that date?

A. Billings were made on the amount of money that was approved by the engineer as of that date.

Q. They were also based on the amount of work or the amount of labor and materials that went into the building?

A. Not necessarily. It was based on what the engineer thought it was worth.

Q. You mean on the part that was completed?

(Testimony of Ross B. Hammond.)

A. If I can, I will explain it a little bit. He starts in with the excavating and he takes each item and, as he goes through, he decides that we have got that much done. Whether we like it or whether we don't like it, that is what he says. When he gets through, he adds them all up and says, "You can have that much money."

Q. On some of the contracts you were only entitled to 80 per cent of the amount which you would estimate?

A. The contracts vary. When he gets through, then they automatically take off 5 per cent, 10 per cent or 15, which they hold back as assurance that you don't break a leg.

Q. The billings which were accrued on your books were for the total amount, without that percentage off?

A. When they get the bill, the percentage is off.

Q. Let's come to the partnership matter. Your boy, you say, was in college up until 1940?

A. Approximately, yes.

Q. Did he work for you during 1940?

A. I believe he did.

Q. How about 1941? A. Yes.

Q. Did he work the whole year of 1941?

A. No, he went in the Army about December. I think it was the 26th, some time after Christmas.

Q. What compensation were you paying him in 1941, do you recall? [161]

A. No, I don't. It was about the same as Petersen, wasn't it?

(Testimony of Ross B. Hammond.)

Q. About \$7,500?

A. Something like that.

Q. What was his job in 1941, before you entered into this so-called partnership agreement?

A. Well, one of his jobs was in Milwaukie, the Milwaukie Housing Project.

Q. The Milwaukie Housing Project?

A. Yes. I don't know what the job number was.

Q. That is Contract No. 207.

A. Okeh. From there he went to the Aluminum Plant.

Q. That was started in 1941, wasn't it?

A. Yes, and I think it was the next number, 208. I imagine there were some six or seven engineers under him, but his responsibility was to see that all the buildings were put in the right spots, both sideways and up and down, and it was a very important matter because the Aluminum Company also had a crew of engineers seeing to the same thing and——

Q. 208——

Mr. Bischoff: Let him finish.

Mr. Winter: I thought he had finished.

A. Well, I was trying to follow through. I think it was shortly after that that they pulled him into the Army.

Q. What time was it? Was it late in the year when they pulled him into the Army in 1941? [162]

A. I am pretty sure it was December 26th, because I think he had a chance to stay home for Christmas, and he was in Fort Lewis the next day.

(Testimony of Ross B. Hammond.)

Q. Then he got back about February 3rd?

A. Well, he was in there about a month.

Q. February 3rd you say you executed a partnership agreement? A. That is correct.

Q. On the same day you executed the two agreements with——

A. ——Mason and Petersen.

Q. ——Mason and Petersen?

A. That is correct.

Q. I will show you what has been marked for identification Plaintiff's Exhibits No. 4 and No. 5, and received in evidence——

Mr. Bischoff: We did not offer them in evidence.

Mr. Winter: You produced them as Plaintiff's Exhibits but you refused to offer them. Did you make an objection to them?

Mr. Bischoff: You have not offered them yet.

Mr. Winter: Yes, we offered them.

Mr. Bischoff: I have no recollection of your offering them.

Mr. Winter: If there is any question about it, your Honor, we would like to re-offer them.

Mr. Bischoff: At this time I object, as incompetent, irrelevant and immaterial and for the reasons previously stated.

The Court: Admitted, subject to objection.

Mr. Winter: Those are the agreements you had with Mr. Petersen [163] and Mr. Mason, are they not, Exhibits 4 and 5?

A. Yes, sir. This one is not. This is Exhibit No. 3. It is not Exhibit 4 or 5.

(Testimony of Ross B. Hammond.)

Q. I have 4 and 5 here. You might as well have all the exhibits. Exhibit No. 3 is the partnership agreement; Exhibit No. 4 is the Mason agreement and Exhibit No. 5 is the Petersen agreement. Is that right?

A. That is correct.

Q. They were all executed February——

A. ——3rd.

Q. February 3, 1942, is that right?

A. That is right.

Q. Where were they executed?

A. In my office, I presume.

Q. Who prepared them?

A. I believe Mr. Jacob.

Q. Mr. Jacob prepared them? A. Yes.

Q. There was also executed at the same time, was there not, a power of attorney which has been marked Defendant's Exhibit No. 30?

A. Yes, sir.

Q. Under the Petersen agreement, he was to get \$7,500 and under the partnership agreement your son was to get \$7,500 and a percentage of the profits, is that right? [164]

Mr. Bischoff: The contracts speak for themselves, your Honor.

The Court: He may answer.

Q. (Mr. Winter): Was it your intention, Mr. Hammond, Mr. Peterson was to get \$7,500 and your son was to get \$7,500.

A. They were each allowed to take \$7,500 as a drawing account.

Q. Why did he execute a power of attorney on the same date?

(Testimony of Ross B. Hammond.)

A. Because, as I remember it, there was a possibility that he was going to be away and, if there was any possibility, I had to have that power of attorney, in case it was called for, and the fact that I was being very particular that this partnership was not divulged, but in an emergency where I had to sign something I had to have a power of attorney on record in case something happened to him, which is always liable on construction work.

Q. Who was your bookkeeper?

A. February 3rd it was Miss Novak.

Q. Rosalie Novak? A. Yes.

Q. You told the Court that was an entirely secret document, that nobody knew about it. Isn't it a fact that Miss Novak executed it as Notary Public, this agreement as well as the partnership agreement and the power of attorney?

A. That is correct.

Q. Then she knew about it, your own bookkeeper? A. I doubt it. [165]

Q. She notarized them, didn't she?

A. That is correct. She had notarized a lot of papers that she does not know anything about, to my knowledge, and I am quite sure—I don't remember all the details as of that time, but in this particular case, I am quite sure, I would be very sure that she did not read this. All she needed to do was to notarize the signatures that were on it.

Q. You say, in connection with the partnership agreement, you did not inform your banker?

A. To the best of my knowledge, I never informed nobody but my son, my wife, and, of course,

(Testimony of Ross B. Hammond.)

I told Mr. Jacob. As I wanted him to write it, he couldn't very well write it up without knowing what he was writing up.

Q. You filed a certificate of an assumed name with the County Recorder, showing yourself as the sole owner of the business, and, when the Corporation was dissolved, you took all contracts in your own name individually? A. I did.

Q. You were general manager of all contracts except as you might consult with Petersen and Mason and your son?

A. I was the head of the organization.

Q. As a matter of fact, you had a power of attorney to handle all the business?

A. That is correct.

Q. Mr. Mason, he was in charge of one project as superintendent, [166] was he not?

A. He was.

Q. One or more?

A. Up until a certain time he was general superintendent.

Q. Mr. Petersen was also a general superintendent or manager?

A. He was a superintendent on individual jobs.

Q. As a matter of fact, your son was the superintendent on the Milwaukie Housing Project in 1941?

A. No; he was the engineer that was laying it out. I forget who was the superintendent on that job.

Q. Did he have a lot of engineers working under him?

(Testimony of Ross B. Hammond.)

A. Well, I wouldn't say a lot; three or four.

Q. He did not pay you any money for the one-fifth interest in the business? A. Not in cash.

Q. He gave you a note, didn't he?

A. Well, it seems to me he did. I can't remember. I can't find it.

Q. As a matter of fact, all the funds that he had was what money he had earned since he came to work for you since he had left college?

A. I certainly have no knowledge of what funds he had. I don't think he had very much money, if that is what you are getting at.

Q. As a matter of fact, you supported him in college? A. Yes, sure. [167]

Q. What management and control of the business did he exercise after February 3, 1942, that he did not exercise in 1941?

A. After he came back?

Q. Yes.

A. Well, his duties at that time—I believe we put him in charge of the Guilds Lake Project.

Q. When you say "we put him in charge," do you mean you and Mason?

A. I talk about the Ross B. Hammond Company as "we." It does not mean "it." I mean "we" because I was "it."

Q. You put him in charge——

A. I guess I am a little like Lindbergh, because I like to talk about "we," because we were all together and we operated all together. That is, Mason and Petersen and Bill and I ran this company, even though I was still boss.

(Testimony of Ross B. Hammond.)

Q. You were still in charge?

A. I was the executive head at the time and when Bill came back I put him in charge of Guilds Lake, which, if I remember right, was something like a million and some-odd dollars of a contract. It was several hundred houses, the first installation at Guilds Lake, for which he was entirely responsible. We had accumulated this University Homes Housing Project which was a five-million-dollar operation and 2,000 homes which they were trying to get ready for occupancy in ninety days, so I took Mason and put him out on that project and so Bill then took charge of the Guilds [168] Lake Housing Project and also helped me in the office because Petersen had his hands full at the Troutdale Aluminum Plant which was also quite a large job.

At the end of this Guilds Lake Project—I think it was not quite completed when they yanked him back into the Army. In the meantime, he had been under my wing pretty close because I was in the office and he was in the office with me. I felt Mason was capable of the University Homes and I didn't pay much attention to it. I felt Petersen was capable of building the Aluminum Plant and I did not pay much attention to him, but I did pay a lot of attention to the rest of it and I paid a lot of attention to Bill because I needed him.

Q. You were training him?

A. I beg your pardon?

Q. You were still training him?

A. I sure was.

(Testimony of Ross B. Hammond.)

Q. Are you still operating now as an individual or a partnership? A. As a partnership.

Q. Who prepared your income tax return for 1942?

A. Mr. Jacob and my bookkeeper have prepared all of them.

Q. Did Mr. Jacob prepare the return for 1942?

A. He prepared all of them.

Q. On that return you do not show any income from the partnership, do you?

A. I don't— [169]

Q. I will show you the return for the year 1942.

A. Is this the individual?

Q. On line 8 you show net profits from business or profession of how much? A. Line 8?

Q. I am looking at the wrong return. Pardon me. What do you show as income from your separate business?

A. Well, this is the return of Ross B. Hammond, individually.

Q. Yes.

A. On line 9 it says "Net Profit or Loss from Business or Profession," and it shows \$149,089.15. That is on line 9.

Q. There is no income shown from the partnership? A. No.

Q. Mr. Jacob, who prepared your return, knew about these agreements, didn't he?

A. I presume he must have. He made them.

Q. And it did not occur to you that it was a partnership return and you were reporting one-half of it?

(Testimony of Ross B. Hammond.)

A. No; as a matter of fact,——

Q. Or 75 per cent of it?

A. I didn't even know. I never had anything to do with making a return. When they told me it was a return and to sign it, why, I signed it.

Q. As a matter of fact, you did not file a partnership, a delinquent partnership return until May 15, 1944, isn't that right? [170]

A. If it says it there, it is right. If that is what it says there, it is right. This is Ross B. Hammond Company all right. There is no date on it. There is some receiving stamp here.

Q. You know that as a matter of fact you did not file it until you prepared your 1943 return?

A. I know all about it and I am trying to answer your question.

Mr. Bischoff: The return in his hand isn't dated. Have you got the original?

Mr. Winter: Yes, he has the original. It shows when it was stamped as having been filed.

Q. In your return for 1943, that is the first time you ever divulged to the United States or to anyone, outside of your wife and Bill, as you say, that any partnership existed, is that right?

A. That is correct.

Q. Although Mr. Jacob, who prepared the return, knew about it, and although your bookkeeper knew about it, that is, she notarized these agreements——

A. When you say that she knew about it, I don't agree with you. I agree with you that she

(Testimony of Ross B. Hammond.)

notarized them, but I am reasonably sure she did not know it because I am pretty sure I would not let her—I am quite sure I would not read it to somebody or let somebody else read it.

Q. You did not let her see it when she notarized it? A. I just—— [171]

Q. Except to put her signature on it?

A. I said, “Notarize these agreements.” They were all made out and were all ready.

Q. Was Bill there? A. Bill, where?

Q. Was Bill in the office when the partnership agreement was executed? A. Yes, he was.

Q. Would you look at the signatures on there, please. A. Yes.

Q. Do they appear to be signed with the same pen and ink?

A. No. I presume he had his own pen. I don't remember those details.

Q. Do you have any recollection that you were there when he signed?

A. I can imagine I was.

Q. You are just imagining? You don't have any independent recollection that you were there, then?

A. I would say I was, yes. I think it was signed right in my office.

Q. Did you have any other profit-sharing agreement with Bill during the year 1941 or 1942, other than this partnership agreement? A. No.

Q. You did not? You say definitely you had no other agreement, [172] profit-sharing agreement?

A. Not that I remember.

(Testimony of Ross B. Hammond.)

Q. Either during 1941 or 1942?

A. That is right.

Q. Did you have any in 1943?

A. No, I had nothing but this partnership agreement.

Q. I think you stated all your contracts with the United States Government were taken in your name, and you also stated that the reason why they were taken in your name was that Bill might not be available to sign any change orders or anything of that nature?

A. That is correct.

Q. You had his power of attorney, with authority to sign and take all contracts in your name?

A. Yes. This was for the reason that it was kept secret.

Q. Was that one of the reasons it would not be necessary to have Bill's signature on contracts, as long as you had the power of attorney? Even if the contracts were taken in the partnership name?

Mr. Bischoff: Objected to as argumentative, your Honor.

The Court: He may answer.

A. It was not the first time I had had Government contracts. In the first World War I was doing the same thing for another contractor, and there were complications that arose with the partnership when we would have Government papers to sign. They just led to more red tape than I have ever been able to get loose [173] from, and for that reason I kept it that way.

(Testimony of Ross B. Hammond.)

Q. Did Mr. Petersen know that in the conduct of the business your son was one of the partners?

A. They knew nothing.

Q. Therefore, he did not exercise any of the rights of a partner in that matter, as one of the bosses over them, over those individuals, did he?

Mr. Bischoff: Objected to as argumentative.

The Court: He may answer.

A. He didn't exercise any, no more than we had in our conferences before he went to war.

Q. He did not exercise any further control than he did in 1941 or 1942? A. No.

Q. He did not have the right to sign checks except with the signature of Mr. Mason or Mr. Petersen or some other one in authority in the office?

A. He had the same right to sign checks as Mr. Mason and Mr. Petersen, and they had to be signed with Miss Novak's signature. The only one in the outfit that had the right to sign a check alone was me, and that was for an emergency. It was rather occasional when I would sign a check alone. In fact, for years, ever since Miss Novak has been there, if it is at all possible, I insist on Miss Novak's signature on a check first, because she is the one that has the responsibility for seeing that the check [174] is properly made out. She and Bill can sign checks; she and Petersen can sign checks and she and Mason can sign checks.

Q. Your son had no authority to draw from the Corporation except to the extent of \$7,500 a year?

A. According to our agreement.

(Testimony of Ross B. Hammond.)

Q. It was the same arrangement, the same agreement that you had with Mr. Petersen and Mr. Mason?

A. As far as money is concerned, yes.

Mr. Bischoff: Objected to as argumentative. The contracts are the best evidence.

The Court: He has already answered.

Q. (Mr. Winter): As a matter of fact, your son did not include 25 per cent—Did your son include 25 per cent of alleged partnership profits for the year 1942 in his return? Did he?

A. I think the return was made up by the same people who made up mine.

Q. He only reported \$7,500.

Mr. Bischoff: Objected to, as the return is the best evidence.

Mr. Winter: If he knows.

A. Well, I don't know. Without the return I can't remember those things.

Q. (Mr. Winter): I have the return.

A. To answer your question, with the knowledge I have of it, I am pretty sure it was not, because the returns were made out at the same time by the same people for both of us. [175]

Q. Did you tell your son at the end of 1942 what his partnership profit was?

A. He knew at all times.

Q. What? A. He knew at all times.

Q. I am asking you if you told him?

A. I presume so, by the time we knew what it was.

Mr. Winter: I think that is all.

Mr. Bischoff: That is all.

The Court: We will resume at 10:00 o'clock in the morning.

(Whereupon, at 4:40 o'clock p.m., an adjournment was taken until 10:00 o'clock a.m., Wednesday, January 14, 1948.) [176]

Court reconvened at 10:00 o'clock a.m. Wednesday, January 14, 1948.

WILLIAM A. HAMMOND

was thereupon produced as a witness on behalf of plaintiff and, being first duly sworn, was examined and testified as follows:

Direct Examination

By Mr. Bischoff:

Q. Will you state your full name?

A. William Allen Hammond.

Q. Where do you live?

A. I live in Washington County, Oregon.

Q. Are you married or single?

A. I am married.

Q. How long have you been married?

A. Six years.

Q. How old are you? A. I am thirty, sir.

Q. You are the son of Ross B. Hammond, the plaintiff in this case? A. I am.

Q. What business are you engaged in?

A. Building construction.

Q. With whom are you associated?

A. With Ross B. Hammond. [177]

Q. In what capacity? A. As a partner.

(Testimony of William A. Hammond.)

Q. When did you become associated as a partner?

A. We became associated as partners in February of 1942.

Q. I show you Plaintiff's Exhibit No. 3 and ask you if your signature is on that instrument?

A. It is.

Q. You signed it? A. I did.

Q. On the date that it bears? A. I did.

Q. Who was present when you signed it?

A. Miss Novak was present and I believe Ross B. Hammond was present.

Q. Mr. Hammond, I show you Plaintiff's Exhibit No. 2 and ask you if you received that instrument? A. I did.

Q. From whom?

A. From R. B. Hammond.

Q. When did you get it?

A. At the same time as the signature, on February 3rd.

Q. You got it at the same time that the articles of partnership were executed?

A. That is correct.

Q. Where were you born? [178]

A. I was born in Pittsburgh, Pennsylvania.

Q. When did you come to Portland, Oregon?

A. Well, I believe I first came here when I was about four years old. I was traveling with my family.

Q. Have you lived here in Portland ever since?

A. I have lived here, I believe, since I was five.

(Testimony of William A. Hammond.)

Q. Will you state what schooling you have had?

A. I attended grammar school in the City of Portland and some high school at Washington High School in Portland and graduated in La Jolla, California, and Culver Military Academy.

The Court: What kind of school is in La Jolla?

A. High school. I was down there when I was sick and I went to school for about four months there or six months.

The Court: How big a town is La Jolla?

A. I think about 10,000 people.

The Court: How far from San Diego?

A. About fifteen miles.

The Court: Which direction?

A. It is just north.

Mr. Bischoff: Q. You were there while you completed your high school studies?

A. Well, it was about my sophomore year. I was sick and had to leave Portland and go south for the temperature and warmth, and I went to school there just for the six months I was there, but I have been trying to give a complete account of the places [179] that I had attended school.

Q. You got credit for that?

A. I believe I got credit for what amounted to four units or six units of high school education. From there I went to Culver Military Academy.

Q. Where is that?

A. That is in Indiana.

Q. How long were you at Culver Military Academy?

A. Two years.

(Testimony of William A. Hammond.)

Q. What was the nature of the training or education you received there?

A. The training was college preparatory.

Q. From there where did you go?

A. I went from Culver to Stanford University in 1935.

Q. From what year to what year did you attend.

A. From 1935 to 1939.

Q. You graduated in 1939?

A. I believe I technically graduated in January, 1940, although I am not positive of the date. I would have to look at the diploma to see whether it was the 1939 class or the 1940.

Q. That is close enough, either the end of 1939 or the beginning of 1940 when you graduated.

A. I was home in January of 1940.

Q. Did you receive any degree upon your graduation from Stanford?

A. Yes, I received a degree of Civil Engineering. [180]

Q. What was the course of study you pursued at Stanford University?

A. Civil Engineering course.

(The Court proceeded to the transaction of other business.)

Mr. Bischoff: Q. Will you explain the nature of the course of study you pursued at Stanford University, particularly with reference to the type of engineering to which you channeled your course?

A. In college education for engineering you are required to study for not any one engineering de-

(Testimony of William A. Hammond.)'

gree. If it is Civil Engineering, a Civil Engineering degree, you still have to study all phases of engineering, mechanical, chemical, structural and so on and, to get any one of these degrees, you have to cover the entire field of engineering. It is a very broad field and requires physics, mathematics, laboratory, heat and power and field surveying.

Q. Did it include any special work with reference to construction engineering?

A. Well, to the best of my knowledge, there is no course prescribed for construction engineering, but it did include strength of materials and applicable studies.

Q. After your graduation from Stanford, did you pursue any further studies? Did you pursue any further studies in any educational institution?

A. No, sir.

Q. During the time that you were attending school, and up to the [181] time of your graduation from Stanford, had you formulated any determination as to the occupation or business or profession that you intended to follow?

A. I had definitely decided, quite some time before that, that I was going to be in the building construction business, even to the extent that I had had many discussions with my father about it, and in the earlier stage he attempted to discourage me. I had my mind made up that I was going to Peru. As a matter of fact, before I even started to college—I believe I was sixteen—I went to work for

(Testimony of William A. Hammond.)

another contractor, and that is when my father said if I was going to work in that business he was the best man qualified to teach me and certainly the most interested in doing so.

Q. How early was it, if you can recall, that you made that determination?

A. I would say I formed that determination when I was about twelve years old. It was prior to Culver and prior to my sickness.

Q. Was that determination a subject of frequent discussions with members of your family, with your father and mother?

A. Yes, it was.

Q. Did that determination have anything to do with channeling your course of study?

A. Very definitely channeled my course of studies.

Q. Did you do any work during the period of time that you were [182] attending school, that is, when you had other time available or during vacation time from your studies?

A. I worked practically all of every vacation from the time I was sixteen in the construction business.

Q. Always in the construction business?

A. Yes, sir.

Q. I will talk about the period up to your graduation. I will talk about the subsequent period later.

During that period, whenever you had work, was it always for your father or with your father, or did you work elsewhere?

(Testimony of William A. Hammond.)

A. Well, I was with my father exclusively with the exception of about—I believe there was one month where I worked for—I can't even recall the name of the organization. It was one with which my father was associated and in which I was very interested in the plant. I believe it was known as the Oregon Housing Corporation.

Q. And that was in the early years?

A. That was when I was still in college and I wanted a paying job and there was about thirty days left before going back to school.

Q. Will you describe the kind of work you were doing in this preparatory period from the early time on, in a general way?

A. My first job was as a regular laborer on a construction job, wheeling concrete and carrying lumber, and in doing so I learned the sizes of nails and about boards and steel, inasmuch as I had [183] to find it to take it to the various places and, to get what was called for by name, I learned the vocabulary, you might say.

Q. Is there an unusual vocabulary as to materials in the construction business?

A. Yes, there is, quite, and from that I also kept time and posted it to what we call our job cost and, at the same time I was doing that, at night and at home and on week ends my father was explaining the interpretations of what I was doing, so that later on I could analyze costs by the unit, and I went from that and was doing time-keeping and labor and occasionally, on Saturdays,

(Testimony of William A. Hammond.)

I was in the office, where I found out how the costs were transferred into billings, and I assisted them in that way in the office.

Q. During all of that time, were you doing that under the supervision of your father?

A. I was under his constant supervision from a very early age.

Q. Was he actively directing you?

Mr. Winter: I think we are entitled to an objection on the leading questions. It has been going on now for some time. I think that we are entitled to an objection and ask that the answer be stricken as leading.

The Court: Ask him another question.

Mr. Winter: Exception.

The Court: What do you mean, "exception"? Mr. Winter, keep yourself in check. In the first place, exceptions are not necessary [184] or allowable under our practice. You are just as big an offender at leading questions as is Mr. Bischoff.

As a matter of fact, when we try cases without a jury, it is entirely within the discretion of the Court as to the extent suggestive or leading questions are permissible. Try to avoid them, however, Mr. Bischoff.

Mr. Bischoff: Q. State what your father did in connection with teaching you the business?

A. Well, to make that concise, he continuously worked with me and checked my work, not for technical addition and subtraction, but for the principles upon which I was working, and he

(Testimony of William A. Hammond.)

would query me quite frequently nearly every time we were together, which was at least every other day, about how I did something and why I did it and where I did it and when I did it and then, when my answers were what I would consider now not quite satisfactory as far as detail and as far as knowing specifically are concerned, why, when I didn't answer the questions to his satisfaction, usually he made me go back—Rather than tell me the answers, he made me go back and think about it for a day until I did pick it out myself. If I failed to, then he would prompt me a little, but his method of training has always been one in which he made me do the work and continue to do the work until he was satisfied I knew what I was doing.

Q. In the various jobs you were assigned to, was this done with relation to the training program that you were undergoing? [185]

A. All my work prior to that time was in the matter of training. I had a very short time to pick things up. I had to move fast, and I was told at the very beginning—I believe Dad's statement specifically was that he had to teach me in five years what it took him thirty-five to learn, and I was getting it thrown at me just as fast as he could.

Q. During that same period of time—I am speaking about up to the time of your graduation—had there been any discussion between you and your father and your family with respect to your ultimate association with your father in business?

(Testimony of William A. Hammond.)

A. Well, there had, but we did not always exactly see eye to eye.

Q. What was the nature of the discussion in that respect?

A. The nature of the discussion was that I did not particularly like being the boss' son, and I had decided that I could go it pretty well for myself, and I do not mean it in any cocky sense, but I just wanted to keep from being Ross Hammond's son on the job, and I had discussed the idea, and very much so, of going to Brazil, which I considered more or less the Pacific Coast of his day. He had come out to the Pacific Coast when he was about my age, and I had thought that Brazil was in a position to become an engineer's country and that I might go down and get in on the ground floor and start working in my own company.

Q. Was that what you were telling your folks in these discussions? [186]

A. I was telling my folks that and I was discussing it with my then bride-to-be.

Q. What was your father's reaction to the program then?

A. Well, we carried out these arguments for quite a while, quite some time. His principal argument was that I was being quite foolish to throw away my associations up here in a company which he had started and which was organized.

The Court: Don't go into that too much.

A. I beg your pardon.

The Court: I was talking to Mr. Bischoff.

Mr. Bischoff: Q. At any rate, in these dis-

(Testimony of William A. Hammond.)

cussions was the subject of a prospective partnership involved? A. Yes, sir.

Q. After you had agreed to stay, what was done?

A. Well, I continued with the same type of education, advancing more rapidly since I had more time and since the operations were more continuous.

Q. Did you then take steady employment?

A. Yes, I took steady employment immediately.

Q. With whom?

A. With Ross B. Hammond.

Q. You have been associated with him in the same capacity ever since?

A. Yes, sir, I have, other than my sojourn in the Army.

Q. State what you did from the time of your graduation, generally, [187] the nature of the work from the time of your graduation to the time the partnership agreement was formed.

A. Well, the nature of my work was as time-keeper and as engineer on the Milwaukie Housing Project and as project engineer at Troutdale.

Q. How big a job was the Guilds Lake Project?

A. The Guilds Lake Project was 358 homes and the total contract was about \$1,142,000, I believe.

Q. You engineered that job?

A. Yes, sir, I did.

Q. Did you do that all alone or did you have a staff of engineers under you?

(Testimony of William A. Hammond.)

A. Well, I had a staff of engineers under me at that time. The actual layout and engineering of Guilds Lake came at a time after I had become a partner and I was frequently acting as Ross Hammond's assistant, inasmuch as Mr. Mason and Mr. Petersen were both out of the office.

Q. I think you said you went into the Army. Will you state when you first went into the Army?

A. I first went into the Army December 26, 1941.

Mr. Winter: What is that date again?

A. December 26, 1941.

Mr. Bischoff: Q. How long did you remain in the Army?

A. At that time I was released on January 20, 1942.

Q. Did you have a commission at that time?
[188]

A. Yes, I had a Reserve Officer—I had been a Reserve Officer for several years.

Q. What was your commission?

A. My commission was Second Lieutenant in Field Artillery.

Q. Why were you released?

A. Well, I have no eardrum in my right ear, and I have a paralysis of the seventh cranial nerve, I believe it is called.

Q. What did you do after you were released from the Army?

A. I returned immediately to Ross B. Hammond's employ, where we had considerable jobs.

(Testimony of William A. Hammond.)

As a matter of fact, I was advised of my release January 5th, I believe, or 4th, and from the 4th to the 20th we were in telephone contact almost daily with regard to the jobs that I knew about and, as soon as I realized that I could not get in, rather than put somebody else on them, we stayed in telephone contact as to them from day to day.

Q. What precipitated the discussion that culminated in the making of a partnership agreement on February 3, 1942?

A. Well, the truth of the matter is that it had been previously discussed and I had—As I recall the situation, I had gotten perturbed at the war and Dad and I had been discussing these contracts with Mr. Mason and Mr. Petersen, and he had been discussing the partnership with me, and the war came and I just told him more or less to go to, that I was going into the service, and we had quite a fight, because he had contacted Senator McNary with regard to my staying out. I could have [189] stayed out.

The Court: Don't go into that, Mr. Bischoff.

Mr. Bischoff: Q. You don't need to develop that in detail. I just want to get what precipitated the making of the contract at that particular time.

A. My return from the service, I believe, did. He said he would like to have me sign up then so I said I would go along with it.

Q. Did you enter into that partnership contract with your father in good faith, intending to be a partner with him? A. Very definitely.

(Testimony of William A. Hammond.)

Q. From that time on, after that contract was made, was the scope of your activities any different or greater or less than it had been before?

A. They were very definitely greater. I had complete scope of activity after that.

A. Will you state briefly and to what extent, what your activities consisted of and to what extent they were greater than theretofore?

A. Well, I was completely handling Guilds Lake which was my sole responsibility and, in addition, I believe that we had about three other jobs or four other jobs, exclusive of Troutdale and University Homes, each of which were directly supervised by Mr. Petersen and Mr. Mason and, in addition, I took care of Troutdale as far as preparing office billings that were submitted [190] by Mr. Petersen following the estimates having been made on the job; they were submitted to the office for billing and I checked the billings and assisted the clerks in getting out definite bills.

Q. Will you please describe generally how estimates were prepared for allowance by the engineers or other offices, and how they were billed out to the Government or other agency?

A. Well, may I ask you to clarify the question? Guilds Lake, for instance, was a lump-sum-bid job and Troutdale was a unit-price job.

Q. Well, describe what you did and how the billings were made for each type of contract. You need not take each individual job, but individual type of contract.

(Testimony of William A. Hammond.)

A. Guilds Lake was a typical lump-sum-bid job. I went out on the last day of the month and determined, in my own opinion, the monetary value of the work on the job and that which we would be paid for. Some of it was not on the job. We had work in Albany, for example, the fabrication of homes that were going up there and the plant in Albany needed to be paid for it, although it had not been put up on the site, and we obtained forms from the FPHA to bill that on, along with the actual foundation, plumbing, sewers, streets and so forth.

Q. At any rate, you accumulated the information you needed to enable you to determine that?

A. I accumulated all the information to determine the monetary [191] value of that work and then obtained the approval of the architect, obtaining a certificate on it, and then obtained the approval of the FPHA itself, and then it was submitted and went through to Washington, on that type of job.

Q. Before it was sent in for payment, was it billed out in the office, after you obtained the approval of the amount by the Engineers?

A. We billed it out on the specific forms for payment by the Government.

Q. After the approval? A. Yes.

Q. You billed just the amount that was approved?

A. That is all we could bill. That is all that would go through. On that type of job, Mr. Peter-

(Testimony of William A. Hammond.)

sen did the preliminary work that I discussed, that I did on Guilds Lake, out at Troutdale, and then those figures were sent in to our main office where I checked them against our bills to make sure that we were getting sufficient money and that we did not leave out something that we had paid for, and then prepared the bill and sent it through channels.

Q. In those cases there was the requisite approval by engineers or other officers?

A. Yes. It was necessary, in the course of completing this billing, to visit these jobs, including Troutdale.

Q. Was that the plan that was uniformly followed in billing [192] for work done?

A. Well, it is in general the plan I always followed.

Q. Was it followed in your business?

A. Yes.

Q. In accumulating the information upon which you estimated the amount to be billed, did you include materials that had been purchased for use on the job?

A. Yes, in every case, to the best of my knowledge. In general, we would collect for items that were referred to as "on site" unless there was a specific clause in the contract which said that "payment will be made only for material incorporated in it," and, to the best of my knowledge, we had no such contract.

Q. Were there any reserve materials on any of these jobs that were not included in your monthly estimates?

A. No.

(Testimony of William A. Hammond.)

Mr. Winter: Object to that, if Your Honor please, as being a conclusion. If there were any such inventories taken, they would be the best evidence. I think it is admitted here that no inventories were taken, and the books do not reflect it.

The Court: The witness may go ahead and answer the question. You know what the question is here about inventories. You have heard it for two days now.

A. In my opinion, there weren't any inventories because of the fact that we billed all materials which we had on the site at every job. We submitted a bill, and in the form of the bill you [193] worked out the amount of money in each instance and then, as an item, included the materials stored on the site; for example, we included the materials stored at Albany that were all prefabricated; they were approved for payment.

Mr. Bischoff: Q. In other words, the billing included all the materials that you had?

A. All the materials and of the types of contracts we had on hand, to the best of my knowledge—that type of contract in which they said “incorporated in the work,” I have not seen one and I haven't signed one.

Q. I omitted something I should have asked you before. You went back into the Army, didn't you, at a later date? A. Yes, I did.

Q. Will you please state on what date you went back into the Army?

A. I think it was October 16th.

(Testimony of William A. Hammond.)

Q. Of what year? A. 1942.

Q. When were you discharged?

A. December 28, 1945.

Q. When you were discharged, what did you do?

A. I returned immediately to Ross B. Hammond Company.

Q. During the time you were in uniform the second time, from October, 1942, to December, 1945, were you overseas or were you in this country all the time? [194]

A. I was in this country all the time.

Q. Were you back home on occasion?

A. I was back there approximately every six months.

Q. Did you keep in touch with your father regarding business matters during the time you were away?

A. We were in constant touch. We met either when I was home on leave or when he occasionally flew down to meet me to discuss matters. When I would transfer, we would arrange to meet between places so we could discuss it, and we carried on frequent telephone conversations.

Q. Was there always correspondence between you?

A. Yes. A majority of the work, however, was discussed by phone because of the length of time involved in correspondence.

Q. Were those business discussions?

A. They were all business discussions.

(Testimony of William A. Hammond.)

Q. Did you get any information about the business or financial affairs of the business?

A. I got continuous information in regard to our financial affairs.

Q. When the partnership was formed, was there any understanding as to whether the partnership was to be made public or whether it was or should be kept secret?

A. We definitely understood that it was to be kept secret.

Q. Do you know the reason for it?

A. I know all the reasons for it. [195]

Q. Were you in court when your father testified as to the reasons for secrecy? A. Yes, I was.

Q. Did you hear what he said about that?

A. I did.

Q. Were those the reasons that induced the maintenance of secrecy?

A. They were. As a matter of fact, I was just as vitally concerned as he was with regard to the other members of the firm knowing about it.

Q. When you became a partner, did you become aware of the manner in which the books of account were kept, or the accounting method?

A. Well, I am somewhat like my father in that I am not an accountant. I think I understand books even a little better than he does, but I am certainly very far from being able to pick up a set of books and understand them. If I sat down and really dug, I could pick out the information, but I am not generally familiar——

(Testimony of William A. Hammond.)

Q. What I would like to know particularly is: Did you become aware as to the particular system of accounting, the method of accounting that was being employed?

A. Yes, I was aware of our system.

Q. What method did you understand was being employed?

Mr. Winter: Object to that, if Your Honor please. The witness says he does now know anything about accounting; he just [196] knows about it in a vague way.

The Court: Answer.

A. It was explained to me that it was an accrual system, and I asked enough questions to find out what an accrual system was. My ability to interpret the details of bookkeeping was vague but my comprehension of the principles, I believe, was correct.

Mr. Bischoff: Q. Did you know that securities had been purchased with firm funds in the name of your father, individually?

A. I was well aware of it.

Q. Were you informed of that by your father?

A. I was informed of all the purchases and sales and values and changes in capital value.

Q. Did you know what was being done with those securities?

A. I knew what was being done with those securities.

Q. Do you know whether they were being used as collateral in financing the operation?

A. Yes, they were.

(Testimony of William A. Hammond.)

Mr. Winter: I submit that is certainly leading.

Mr. Bischoff: I will withdraw the question.

Q. State, if you know, what was being done with the securities.

A. I know what was being done. In our type of business, it is constantly necessary to have collateral to use for bonding and, in some cases, to use this collateral in the bank actually to meet your payrolls. Your situation may well be one in which you have a lot of assets but you must be able to turn them into cash [197] to use to carry your payrolls and your material bills until such time as the money is coming back in.

Q. You were aware, during the years 1942 and 1943, that your partnership interest had not been reflected on the books of the company, as they were being kept at that time?

A. No, I was not aware of that.

Q. Did you have anything to do with dictating the manner in which the accounts would be kept?

A. No. The only thing I got were reports and direct answers to questions which I asked with regard to the financial status and our job status and material status and the contracts.

Q. Did that include information as to the amount of your share of the interest in the business?

A. Yes, I knew what my shares were but I did not know what the details of the books were. I got what might be a financial statement rather than the details of the books.

(Testimony of William A. Hammond.)

Q. You are familiar with the operations that went on under Contract No. 208, the Troutdale Aluminum Plant? A. Yes, I am.

Q. The books of the company disclose that in 1942 there was \$10,056.55 of income from that contract with costs in that year of \$1,057,409.83, with a net loss for that year. Are you familiar with conditions which prevailed on that job and which account for that situation?

A. I am very familiar with that particular phase. [198]

Q. Please state, if you can, without going into too much detail, what produced that condition?

A. Well, frequently the unit cost at Troutdale of the concrete—we had a definite price per yard of concrete, unit price per yard, based on 30,000 yards of concrete and, consequently, during the year, we charged for our overhead and our materials and forms and so forth to 30,000 yards, which was what we had been given to believe was the amount that was to be involved. That was already twice the amount we had figured, but we had been led to believe there would be 30,000 yards, and we followed the unit cost as we proceeded with the job.

Q. That is, for billing?

A. For billing and also for our own analysis. Our superintendent and myself continuously make analyses as to how our unit costs are doing, and, that was in 1942, both Mr. Petersen and myself

(Testimony of William A. Hammond.)¹

informed Ross Hammond that we were actually losing money on the Aluminum Company job and would lose money unless we ran over 30,000 yards of concrete, and it was after I left, when they finally computed the books—but I remember and distinctly recall at that time the analysis was that we were going to lose money on the job.

Q. That was due, was it not, to the necessity of spending all the money in preliminary work and the furnishing of equipment?

A. It is not only equipment but the forms. We built forms for the pot room, we built forms for the ore bin, and then these [199] forms were changed. When we got about halfway through we realized that we were not going to come out on it. It was just a case of having given too low a figure for the job of 30,000 yards. If it went the way it was supposed to, we would have lost money on the job.

Q. Did you ultimately get an increased amount, get an increase in the amount of yardage?

A. Increased yardage was gravy, as far as the forms were concerned and as far as the equipment was concerned, because they were already fabricated and had just been charged to the supposed 30,000 yards and, as I say, it may be termed gravy, when it went beyond the original idea.

Q. Would you say whether that would account for the profit that was reported in 1943, reported in 1943 for 1942?

(Testimony of William A. Hammond.)

A. Yes. As you heard me state, I left in 1942 but, on my last analysis, we were losing money on Job 208. It was after I was again in the service and got reports from Ross B. Hammond that I realized that we were doubling the job, almost, in quantity, and, therefore, our overhead remained constant and we were going to come out of that all right the next year.

Mr. Bischoff: You may cross-examine.

Cross-Examination

By Mr. Winter:

Q. As I take it, you went to work for your father when you graduated from school in 1940?

A. The spring of 1940. I had worked for him prior to that.

Q. I mean, after you graduated from college?

A. Yes, I believe so,—I believe it was January, 1940.

Q. After you received your degree in Civil Engineering?

A. That is correct.

Q. What was your work with your father during that time, that year?

A. During the year 1940?

Q. Yes.

A. I was timekeeper and assistant to the superintendent for the Clark County Court House.

Q. Who was superintendent of construction of the Clark County Court House?

A. Mr. Petersen was.

Q. Mr. Mason was also associated with your father at that time?

A. Yes, he was.

(Testimony of William A. Hammond.)

Q. What was your work in that connection? What were your duties?

A. My duties were keeping track of the time on the job, the materials delivered to the job, assisting in scheduling of deliveries, and assisting in work to be done the following week and the following month; in other words, progress layout.

Q. In preparing estimates, too?

A. I assisted Mr. Petersen in that, at the end of each month.

Q. Was that the only job you worked on in 1940?

A. No. I believe that that job at Milwaukie started in 1940, [201] but I don't know definitely, but I think it was a defense housing project at that time. We were not at war and that is why I am inclined to believe that started in 1940.

Q. Was that Milwaukie Housing Project a cost-plus-fixed-fee contract or a lump-sum contract, or what kind of a contract was that?

A. I am quite certain that was a lump-sum contract.

Q. Are you familiar with the provisions of the Government with respect to lump-sum contracts?

A. Somewhat familiar. I would want to read it at any time that I was going into it again.

Q. Under these contracts, that type of contract, the Government, as the owner, makes partial payment as the work progresses upon application of the contractor and certified to by the architect-engineer; payments to the contractor are 90 per cent of the labor and materials incorporated in the work at the end of each billing period, is that right?

A. I don't know. You read it, sir.

(Testimony of William A. Hammond.)

Q. Is that a usual term of these contracts? Did you read it?

A. I don't recall it as a usual term of the contract. It is a standard form of contract but I don't recall it as a usual term.

Q. In other words, an estimate would be made at the end of the month, or some time during the month, of the value of the labor and materials incorporated in the work, and you would bill them for 90 per cent of that amount, would you not?

A. You bill them for all of that and then the retained percentage is retained as prescribed in the contract. Those things are specifically covered in the individual contract, and to know what it was on that particular job I would have to read that particular contract.

I believe, as I have already stated, that we collected for materials, as I remember, "suitably stored on the site."

Q. How do you account for the fact that, in connection with the Troutdale Aluminum Plant, you only accrued \$1,036,623.10 but yet had a cost of \$1,057,409.83? How do you account for that if you were able to bill for all of the materials you had purchased and which had accrued on the job?

A. That was a unit-cost job and if we gave a price of——

Q. I am talking about Troutdale. Only part of it was a unit-price job, was it not?

A. Well, this part you are referring to, that was a unit price, so many dollars per cubic yard of

(Testimony of William A. Hammond.)

concrete, and it cost us more per cubic yard, more per unit, than we could bill.

Q. Would you say you had any materials that were not taken into consideration by the taking of an inventory of materials on hand, or cement, or the amount of work which you could not bill at the end of the year, as your father said?

A. There was no definite inventory made, no, but we billed for all the material on hand that we could collect for.

Q. You accrued all the material which you had purchased regardless [203] of whether it was in the job, delivered, or not?

A. I don't quite follow your statement.

Q. Didn't you accrue the material which you ordered on the job?

A. Not unless it was delivered or we had paid for it. If it was in our office as an invoice, it was accrued because, if it was invoiced, it was delivered, but not if it had been ordered. We might order something and it would be two months before we got it.

Q. Were all the billings made at the end of the month, or would they be made at various times during the construction period?

A. In most cases, our billings were made at the end of the month, unless it was on a specific job and then it might have been, on occasions, submitted in the middle of the month, but generally it was the end of the month that the billings were made, in all of our operations.

(Testimony of William A. Hammond.)

Q. When you were making your estimates to submit to the engineer, the Government engineer, the owner's engineer, or architect, did you make any record of the materials on hand or any estimate as to the work which was completed for which you could not make any billing at the end of the year 1942?

A. I couldn't say exactly at the end of the year 1942, because I was in the Army at that time, but it was not our practice to make any inventory. It was our practice, however, to bill an individual job for materials, as I said, suitably stored on the site, in addition to those incorporated in the building. [204]

Q. That is to say, 75 per cent of the materials stored on the site the first day of the month, as estimated by the architect-engineer, is that right?

A. Are you reading from another contract?

Q. Yes.

A. In that contract, it may be. I would have to check the specific contracts that we had on any one job.

Q. Wasn't that a general provision of all Government contracts on lump-sum jobs?

A. I don't know whether you read two different paragraphs.

Mr. Bischoff: Counsel's question is confusing.

The Court: Don't interrupt. I don't want any interruption.

Q. (By Mr. Winter): You never billed for 100 per cent of labor and materials, either stored or in

(Testimony of William A. Hammond.)'

construction, at any time under lump-sum contract, did you, because each contract provided you could not bill for that, isn't that right?

A. In nearly every case, you billed 100 per cent and then they allow you whatever retained percentage is called for.

Q. You got a net of 80 or 90 per cent?

A. Whatever the contract might provide, depending upon the individual contract.

Q. Do you know whether you accrued the whole 100 per cent on your books, or the amount which you were legally authorized to bill for?

A. I do not. [205]

Q. You don't know that, do you?

A. I am afraid I don't.

Q. No inventory was made of materials remaining at the end of the year as to work which was incorporated in the building, for which you could not make any billing?

A. Inventory of work incorporated in the building?

Q. No appraisalment of work incorporated in the building was made at the end of the year?

A. No, nothing other than the amount we billed for; that was all that we could charge.

Q. In the construction business there are a lot of costs in connection with preparation, getting equipment and all that sort of thing, all those costs that are involved in the construction business?

A. Yes.

(Testimony of William A. Hammond.)

Q. They are not reflected in any structure that may be erected; they are in preparation?

A. Quite frequently they are reflected. As a matter of fact, in breaking down your estimate, you charge those things which are necessary for preparation into your earliest stages of construction and most architects and most engineers recognize them as legitimate costs at that stage.

Q. Did I understand you had charge of the Milwaukie Housing Project?

A. No, sir. I was engineer of the Milwaukie Housing Project. [206]

Q. How do you account for the fact that you show on your books income of \$7,634.09 and a profit of \$7,058.97, practically the same amount of profit that you had income? Did you make 100 per cent profit on that contract?

A. What?

Q. In 1943?

A. As a matter of fact, that contract was a hundred or several hundred thousand dollars and \$7,000 would not be 100 per cent profit, so I don't understand.

Q. You reported in 1943, on your alleged partnership return, that you had an income for that year from that job of \$7,634.09.

A. Yes.

Q. And that you had total costs of \$7,058.97.

A. That would not leave 100 per cent profit.

Q. I mean, a profit of \$7,058.97 and costs of \$575.12.

A. I know the issue you are making there, sir, but that was the end of a total contract which, as

(Testimony of William A. Hammond.)'

I understand it, we had billed up to that time. I assisted in preparing the original estimate. It is general practice to bill everything that we can get in a lump-sum contract. If the architect does not allow that, we have no way to show it. Our costs are not determined by our estimate. Our costs are determined by what we pay, and the amount we can collect is reflected by the architect's estimate.

Q. Your costs are determined, then, by the full amount of materials which you have ordered, whether on the job or not or [207] whether it is there at the end of the year, labor costs and overhead——

A. If we have paid them, they are.

Q. In other words, the costs are accrued, but the amount of income is not all accrued at the end of the year, is that right?

A. I don't follow your statement.

Q. You accrued costs of \$575.12, and you show a profit of \$7,058.97. In other words, you have a profit of over \$7,000 on costs of \$575.12.

A. To the best of my knowledge the \$7,000 pertains to the total contract which we had been unable to collect because we had been unable to obtain a certificate for that. They claimed it was work we had not done, and this was an estimate of \$7,000-odd work we had not done, according to them. As a matter of fact, we thought we had complied with the contract in toto but they said they would hold up an amount equal to \$7,000, so we did the work and it happened that the costs were \$500, but they were

(Testimony of William A. Hammond.)

compelled by the contract to pay us the amount of our lump-sum contract. Is that a clear answer?

Q. In other words, the work for which you received \$7,634.09 was done in 1942, the actual construction work? A. No, it had not.

Q. What?

A. No, it had not. There was part of the contract—For instance, a lump-sum contract is \$100. It does not matter how much [208] money I spend. I might have to spend \$150,000 or I might have to spend \$30,000, but they have to pay whatever the contract price is. They took exception, and that is what happened in that case. They took exception that we had not completed the work and we believed we had.

Q. That represented the retained percentage of contract work that had been performed?

A. I couldn't tell you for sure whether it was a retained percentage or just the fact that the architect did not certify it because he thought there was \$7,000 more work to do. We didn't think there was that at all.

Q. In any event, was that a lump-sum contract?

A. I believe it was. I would have to check the language of the contract to be positive.

Q. You were only paid on those kinds of contracts, that type of contract, 90 per cent of the labor and materials incorporated in the work, and 75 per cent of materials that were stored on the job, up until the completion of the contract, is that right?

(Testimony of William A. Hammond.)

A. I have said several times I don't know. There are different contracts. It might have been 90 and 75; it might have been 85 or 80—it depends on the particular contract. If it is part of the records, you can check it.

Q. In any one of the contracts did they pay the full 100 per cent? Were you entitled to bill for the full 100 per cent without discount? [209]

A. There may have been one or two that were 100 per cent. It is not common to have a 100-per-cent payment.

Q. Most of your contracts were with the Government? A. Yes.

Q. I mean, your large contracts?

A. Yes; as a matter of fact, they were.

Q. All Government contracts, however, provide that only 90 or 85 per cent, as the contract may be, would be paid upon an estimate being submitted?

A. Normally that is the situation.

Q. You think possibly you may have been working on the Milwaukie Housing Project during 1940?

A. I am not positive of dates. That is seven years ago.

Q. Did you start to work on the Milwaukie Housing Project in 1942 after you got back from the service?

A. No, I did not. When I got back from the service, January 30, 1942, I handled, I believe, the tail end of Milwaukie as assistant general superintendent, not directly on that job.

(Testimony of William A. Hammond.)

Q. Who was in charge of that job, Petersen or Mason?

A. I believe one of our other superintendents.

Q. For the year 1941, when you worked, you worked for a salary for your father, did you not?

A. In 1941?

Q. Yes. A. Yes, sir. [210]

Q. And he paid you a salary of \$4,626.76 for your services during that year up until the time you went into the service, is that right?

A. I presume the figure is correct.

Q. Then, again in 1942, when you came back from the service, you were put on a salary of \$7,500 a year, were you not?

A. Yes. Listen, I was not. I was put on a drawing account of \$7,500.

Q. Whether you call it a drawing account or not, that was the amount that you were allowed to withdraw from the so-called partnership?

A. That is right. I drew it monthly in the same category as salary, but it was a drawing account and distinctly understood.

Q. Are you familiar with the books to the extent to know whether or not there was any capital account set up on the books for yourself as a partner?

A. No, I am not familiar with it. I was getting reports as to my standing.

Q. You did? A. Yes, I did.

Q. When did you get your report as to your standing?

A. Well, I got reports, as a matter of fact, whenever I asked for them, but I got one at the end of

(Testimony of William A. Hammond.)

the year, rather, about February, as to what the status had been on December 31st.

Q. December 31st, 1943? [211]

A. Every year.

Q. I mean 1942. We are talking about 1942, now.

A. I got a statement.

Q. You filed an income tax——

Mr. Bischoff: Don't you want an answer to that question?

Mr. Winter: I thought he had finished.

A. I got a statement of where I stood financially every year, and that would include 1942.

Q. When you filed your return March 15, 1942, you reported your partnership, did you?

A. Well, I don't know. I am like Mr. Hammond. I relied upon the bookkeeper and counsel to prepare what I should submit to the Government.

Q. You are a college graduate, aren't you, Mr. Hammond?

A. I am.

Q. And when it shows in line 1 "Salary or other compensation for personal services," wouldn't you consider that to be partnership income?

A. If I prepared my own personal statement, personally, I would spend a great deal of time reading it.

Q. You signed that return, didn't you?

A. Yes, I did.

Q. You were interested in the amount of taxes you were going to pay or going to be required to pay Uncle Sam?

A. Yes, I was. [212]

(Testimony of William A. Hammond.)

Q. And you were interested in making a correct return? A. Yes.

Q. Weren't you? A. Yes, sir.

Q. If you were not making a salary but if you were receiving it as partnership income, would you be interested in showing it as partnership income?

A. I don't know how to answer that question without adding to it that I was in the hands of what I believed was good counsel, and they were preparing the returns for me to sign; they were very familiar with our books and——

Q. Did you intend to keep this partnership a secret even from the Government?

A. I don't believe that we thought of it in those terms we had been so concerned with our organization and——

Q. You had given your father, February 3, 1942, a power of attorney? A. Yes, I had.

Q. And you understood he was going to run the business under that power of attorney?

A. No, sir.

Q. Did Mr. Mason or Mr. Petersen know you were a partner February 3rd, 1942?

A. No, they did not.

Q. What did they consider you, as still a son of the boss? [213]

A. They may have. I was much more concerned with retaining them.

Q. You assumed no more responsibility, so far as they were concerned, or so far as anyone else was concerned, other than your discussions with your father after February 3, 1942?

(Testimony of William A. Hammonnd.)

A. Prior to the partnership, they had the same relationship. As his son I was able to give orders. I did not go around doing so, but I had the authority to.

Q. Was there any difference between your relationship with Petersen and Mason after February 3, 1942, than there was before?

A. There was considerable difference in that prior to that time Mr. Petersen and Mr. Mason had been in the office, and at the time we made this other arrangement, they were called upon to be out directly on their jobs, and it didn't require that I have the same relationship. I immediately stepped into the office from which they had been removed and I became general superintendent in fact——

Q. Did they understand that there had been a change in your relationship with your father? They didn't know that there had been any change?

A. We certainly didn't want them to know it.

Q. You certainly did not want the bank to know it, either?

A. Well, the principal reason for that was that then Mr. Mason would know it.

Q. You knew the contracts were being taken in your father's name, [214] individually?

A. Yes.

Q. And you knew an assumed business name certificate was filed with the County Recorder in the name of your father, individually, as the owner of the business?

A. I didn't think of that particular subject.

(Testimony of William A. Hammond.)

Q. As a matter of fact, you didn't need to tell anyone of the secret arrangement except your father and your mother?

A. We have said that, that we tried to keep it secret.

Q. Who were present when Mason's and Petersen's agreements, Exhibits 4 and 5, were executed?

A. I believe that all of these agreements were executed on the same date in the same office, and that I was there, probably. It might have been I was in the next office and they executed them, but I saw them immediately after their execution.

Q. Were you present when Mr. Petersen and Mr. Mason signed their agreements?

A. I couldn't swear to it.

Q. Were they present when you signed this so-called partnership agreement?

A. I am quite positive they were not present when I signed mine because I was definitely trying to——

Q. Did you give them to understand that you also were on a profit-sharing arrangement?

A. I didn't give them to understand anything. That was none [215] of their business.

Q. They had access to the books and accounts?

A. I know that they had access, but we were not—we had tried to keep the partnership out of anything that they had access to.

Q. If you changed and assumed a different managing position after February 3, 1942, that at least was not told to Petersen and Mason?

(Testimony of William A. Hammond.)

A. Circumstances were such that their conditions changed, too. Mr. Mason, for example, had been general superintendent of Ross B. Hammond Company, and at this time he was not even acting as that. He was superintendent of a very large job. He had changed his capacity completely which made it unnecessary for us to inform him of anything. They were both taken out of the office which gave me a chance to assume duties and responsibilities of a partner and general superintendent without having to confer with or advise them, and they took orders from the office which I represented without having to tell them that.

Q. When you filed your return March 15, 1943, a year and three months after the original partnership, you show on your return as salary \$7,945.01 salary.

A. I don't know. In 1943 I was in the Army and I signed these papers which our counsel had prepared and which our bookkeeper had prepared and, frankly, sir, I didn't go into detail.

Q. Mr. Jacob knew you were a so-called partner, didn't he?

A. As a matter of fact, I don't think Mr. Jacob himself prepared it. I knew that he personally knew it, but his office did not, [216] nor did our bookkeeper. I had personally thought she probably did, but I realized she did not know, and I know that his office did not know it. The bookkeeper prepared the statement, as a matter of fact.

Q. On May 15, 1944, or two years and five months later, you filed an amended return, is that right?

A. That, I believe, is correct.

(Testimony of William A. Hammond.)

Q. That return is subscribed and sworn to before Mr. Jacob, your counsel?

A. Yes. I believe Mr. Jacob advised me that I had made a mistake and that he wanted to correct it.

Q. That was the first time you included any of this alleged partnership income in your return?

A. That was the first time I realized that it had not been previously correct.

Q. As a matter of fact, you know that a percentage of the profit had been charged on the books, that is, yours, Mason's and Petersen's, had been charged to Contract 208? Did you know this to be a fact, that Job 208 was charged with some \$47,000 as overhead expenses or salaries, \$47,254.08, that is, the Troutdale job? Did you know that?

A. I don't know it to be a fact but I would presume it is correct since Mr. Petersen spent his entire time on the job.

Q. Was it your practice to charge the salaries of superintendents such as yourself, Mr. Petersen and Mr. Mason, to the job on which [217] you were working at that time?

A. That was quite the normal practice. When we were directly superintendents, that bore the cost of that job and when we were general, we were spread over several jobs.

Q. On the Guilds Lake job in 1942, \$53,307.66?

A. That is very proper.

Q. It was your practice to so charge the overhead?

(Testimony of William A. Hammond.)

A. Our practice was to charge all costs of supervision to a job, because that is what it was. It cost us that much to complete.

Q. How about Job 211?

A. Which job is that, sir?

Q. University Homes, that housing project, a cost-plus job.

A. That was Mr. Mason's. He was superintending it and he had practically a separate office of his own.

Q. He was general superintendent of that particular job?

A. That particular job was big enough to be a business by itself, sir, for a period of 120 days or so.

Q. Were you in charge of the Guilds Lake job?

A. Yes, Guilds Lake.

Q. During all of 1942?

A. I left in 1942, in October.

Q. Until October? A. Yes.

Q. Who was in charge of the Troutdale Aluminum Plant job?

A. Mr. Petersen was directly the superintendent, and that particular [218] job came under the supervision of the main office, contrary to University Homes which did not. In fact, practically nothing was submitted to the main office on University Homes. We tried to keep it separate. We set up a separate payroll account. Troutdale was under the supervision of A. V. Petersen; 100 per cent of his time was spent there, and then it was

(Testimony of William A. Hammond.)

also under my general care and Ross B. Hammond's general care.

Q. I don't believe you stated, Mr. Hammond, when you were married. You say it was about six years ago. Do you recall when you were married, the date?

A. February 21, 1941.

Q. I take it you were drafted in December, 1941?

A. No, sir, I never was drafted.

Q. Well, you were called in the Reserves?

A. Yes, I had been a Reserve Officer for some time, and I received telegraphic orders to report to Fort Lewis for duty with the Artillery. I was there from the 26th of December, 1941, the first time to the 20th of January, 1942.

Q. Then you returned to Portland at that time?

A. Yes, sir, I was ordered to return to Portland by the 20th. I got back, I think, on the 19th.

Q. Ordered to return to Portland?

A. In the Army they issue orders.

Q. That is, they released you from the service?

A. As a Reserve Officer, you are always in the service. You [219] are just subject to orders to report to active or inactive duty.

Q. Did you expect to later be called to the service?

A. Quite frankly, I didn't know. I didn't really expect to, because I had fought pretty hard to get in and stay in the first time. However, I was ready to go at any time for any type of training

(Testimony of William A. Hammond.)

they might want. I had had nine years' training in military service.

Q. Then you were not called again until October of 1942?

A. I was not called in October, 1942. I asked for a physical, but I think it was October 1st. I stalled the physical for ten days because I had a hunch it would mean I was going in and I wanted time to clear up my matters. Then I took my physical and I was correct—I think three days after I had taken my physical and I had signed another waiver, waiving any rights to collection because of my physical defect, then they gave me three days to get in. I mean, they gave me three days to report to Santa Ana, California, on October 12th.

Q. The only explanation you can make of the reason you did not include your partnership income in your return for 1942 is that somebody else made the return and you did not know about it?

A. I would say that I had every confidence in the world in the people who were making the returns for us. They had been doing it for quite a number of years and, rather than to take a lot of my time to try to figure out that Government stuff, I certainly would expect them to have prepared it correctly. [220]

Q. Did you actually believe you only had an income of \$7,944 in that year when you filed the return and that you only had a tax of \$1,474?

A. As a matter of fact, I probably did not give it much thought. I presumed it to be correct and

(Testimony of William A. Hammond.)

just signed it, and also signed the check that they had ready for me to pay it with.

Q. Do you mean to tell the Court you presumed the return to be correct, when you had actually \$45,000 income—\$44,629, when you read that return, Mr. Hammond?

A. I don't remember reading that return, to tell you the truth.

Q. You knew how much taxes you would have to pay, didn't you?

A. If I had known that it was wrong, I would not have signed it.

Q. You are a college graduate?

A. Yes, I am.

Q. You were twenty-four years old or about twenty-four years old?

A. At that time, yes.

Q. And a graduate engineer? A. Yes.

Q. You were claiming to be a member of this partnership handling millions of dollars in contracts? A. Yes, sir.

Q. Do you mean to tell this Court you did not know you had a tax liability of more than \$1,400 on an income of \$7,945, [221] Mr. Hammond?

A. Mr. Winter, we were handling so many papers and so much money at that time I might not even have known when—known what I was signing, other than to know that it was prepared and given to me by people who should know what they were doing.

Q. You are familiar with the jurat?

A. Yes, I am, sir.

(Testimony of William A. Hammond.)

Q. You declare, under pains of perjury, that the return includes all your income, don't you?

A. Yes.

Q. And yet you tell us that you had been advised you had partnership profits of \$44,000?

A. Yes.

Q. That is the only explanation you can give us?

A. You are putting these figures in my mouth. I presume if they come out of the record they are correct.

Q. Just take a look at your return.

A. This is an amended return.

Q. There is the original return and the amended return. That is your signature, isn't it?

A. Yes, both of them are my signature.

Q. Where were you when you signed it?

A. Well, I will have to see when I signed it, sir. I believe this was in the Army, the first one, March 15, 1943; I would have been at probably Williams Field, Arizona, and the other date is [222] 5/15/44—I believe I was home on leave at that time. I probably flew home because my mother was sick. I don't know which it was, but I was back in Portland for a matter of two days and then back on down to the Army.

Q. These are your returns and your signatures?

A. Yes.

Q. You swore to them as being correct at the time you filed them?

A. Yes, sir.

Q. Do you have any other explanation as to the reason why?

(Testimony of William A. Hammond.)

A. The explanation, sir, is that when they are prepared by adequate help and intelligent help that you need—If there was a mistake, as I understand there was in this case—and Mr. Jacobs corrected it—we did everything in our power to correct the mistake we had made. We have always done that.

Q. You told us, Mr. Hammond, that you were advised constantly of your partnership profits in this matter.

A. But I didn't read every matter of detail included in the income tax returns. It takes our bookkeeper literally months to make them up. I certainly cannot digest them or even understand them unless I spend equivalent time doing it.

Q. When all of your income is from salary or from the partnership, and you have been furnished with the figures, you mean to tell us you cannot understand how they put down that amount of salary or partnership return? [223]

A. I am not meaning to say that at all. I could, but it takes time and, as far as I am concerned, my time is valuable, and we have excellent help to do it.

Q. How did you receive the information? How did you receive the information as to your partnership profits?

A. Those were strictly in discussions with Ross B. Hammond.

Q. Over the telephone?

A. Not necessarily; sometimes over the phone and sometimes when we were visiting.

(Testimony of William A. Hammond.)

Q. Have you any record of the partners ever having submitted any partnership records showing the income to which you were entitled?

A. As a matter of fact, I may or may not have. If I do, it may be in my personal files, but I have never been concerned about it, Mr. Winter.

Q. All your work in construction has been under the direct supervision, control and direction of your father, hasn't it?

A. No, Mr. Winter, that is not correct. We are partners, and, technically, I may tell him we are not going to do something or I may go out and do something, but he is my father and I have a great deal of respect for his opinion and, therefore, we are probably mostly guided by him.

Q. As a matter of fact, as your father testified, when you bid on a contract, he calls in you and Mason and Petersen and the four of you consult?

A. That is right. We consult quite frequently in our business.

Q. Do you, as a matter of fact, however, exercise any more control or jurisdiction on any contract to which you are assigned than Mr. Petersen or Mr. Mason? A. Technically, I do.

Q. Or do you exercise any less control? Did you answer? A. Yes, I do.

Q. Over Mr. Petersen and Mr. Mason?

A. Yes, I do.

Q. Any more than you did before you were a so-called alleged partner? A. Yes.

Q. Give us one example.

(Testimony of William A. Hammond.)

A. The fact that I had sent Mr. Petersen out to get things, the fact that I allowed him to go and get things, does not mean I did not exercise it. I exercised it, but I did not come out and give him an order. I didn't have to. Just exactly as a Lieutenant in the Army, you don't always have to order a Sergeant. You can ask him to do something and he does it and you are exercising your control.

Q. You say you had considerable control because you were your father's son. I think that was your statement. A. I probably did.

Q. You are the only son? Your father has no other children? A. That is right, sir. [225]

Mr. Winter: I think that will be all.

Mr. Bischoff: That will be all, Mr. Hammond.

(Witness excused.) [226]

ROSALIE NOVAK

was thereupon produced as a witness on behalf of the plaintiff and, being first duly sworn, was examined and testified as follows:

Direct Examination

By Mr. Bischoff:

Q. Your name is Rosalie Novak?

A. Yes.

Q. Where do you live, Miss Novak?

A. Portland, Oregon.

Q. How long have you lived here?

A. Since 1946.

Q. Since 1946?

A. Yes. Wait a minute. 1936. I am sorry. 1936.

Q. What is your occupation?

(Testimony of Rosalie Novak.)

A. I am office manager and head bookkeeper and what have you for Ross B. Hammond Company.

Q. When did you enter the employ of Ross B. Hammond Company?

A. The first of February, 1942.

Q. What was your occupation before that?

A. Just immediately preceding, I was doing cashiering work for a clothing manufacturer.

Q. How long had you been doing that?

A. I believe eleven months.

Q. What was your occupation prior to that?

A. I was doing all the bookkeeping and secretarial work for an [227] oil burner manufacturing company.

Q. What company was that?

A. The Duplex Manufacturing Company.

Q. You were in the employ of Robert T. Jacob for a while?

A. I was, from the time I first started working up until the time I went with the Duplex Manufacturing Company.

Q. Do you remember the date when you entered Mr. Jacob's employ?

A. August 3, 1937.

Q. When did you leave his employ?

A. 1940, I believe, May. That would be twenty months before I started with Ross B. Hammond Company.

Q. What training have you had in bookkeeping and accounting?

(Testimony of Rosalie Novak.)

A. I took everything in the business course that I could in high school and I had a secretarial business course in a business college.

Q. Here in Portland?

A. Yes, in Portland.

Q. When you entered the employ of Ross B. Hammond Company, was that in the capacity of head bookkeeper? Were you placed in charge?

A. Yes.

Q. There was nobody over you in that organization? A. No, not in the way of office help.

Q. From the time you entered the employ of Ross B. Hammond Company, will you state what your major duties were? [228]

A. Well, I supervised everything in general and kept Mr. Hammond's personal books and the company books, I supervised completely, although a part of the time I kept them myself and part of the time there was somebody else doing that.

Q. Did you have authority to sign checks?

A. I had authority to sign payroll checks alone and I had authority to sign all—I was the only one authorized to sign checks with someone else except Mr. Hammond. Mr. Hammond could sign them alone, although I usually always signed them also.

Q. Miss Novak, I show you Plaintiff's Exhibit 3 and ask you if your name appears upon that document?

A. Yes. I acknowledged the signatures.

Q. You were also a Notary Public, at that time?

A. I was a Notary Public, yes.

(Testimony of Rosalie Novak.)

Q. How long after you entered the employ of Ross B. Hammond Company did you take the acknowledgment on that paper?

A. I believe it was the next day. It was just after I came there.

Q. When you acknowledged the signatures on that paper, were you told the contents of that paper? A. No, I was not.

Q. Did you read it to learn what the contents were? A. No.

Mr. Winter: We object to leading questions, if your Honor please. [229]

The Court: Answer the question.

A. No, I didn't read it.

Mr. Bischoff: Q. Were you told by anyone that the document was a partnership agreement?

A. I was not. All I was asked to do was to acknowledge these signatures.

Q. And that is what you did?

A. And that is what I did.

Q. Were you told to make any entries in the books of the company with respect to any partnership arrangement between Ross B. Hammond and his son, William A. Hammond?

A. No, I was not.

Q. At any time during the year 1942 were you aware of the existence of any partnership between Ross B. Hammond and his son, William A. Hammond? A. No, I was not.

Q. When did you first become aware of the existence of a partnership between Mr. Hammond and his son?

(Testimony of Rosalie Novak.)

A. Well, it was either the latter part of 1943 or the early part of 1944, before the 1943 returns were filed, made and filed.

Q. That was in the course of the preparation of the income tax return for the year 1943?

A. At the end of the year and when the returns were being worked up.

Q. How did the information come to you? How did you become aware [230] that there was a partnership in existence at that time?

A. Well, I believe Mr. Hammond and Mr. Jacob were discussing it, and that was when it came to my attention and I was told about it.

Q. Did you prepare the income tax return for Mr. Ross B. Hammond for the year 1942?

A. Yes, sir, I did.

Q. At that time did you know that there was a partnership in existence?

A. At the end of 1942, no.

Q. I show you the income tax return for the year 1942 of Ross B. Hammond, a part of Plaintiff's Exhibit No. 6. Will you please look at it and state who prepared that return?

A. Yes, I did.

Q. Upon what basis did you prepare it?

A. I followed procedures in previous years.

Q. At the time you prepared that return, did you know that there was a partnership in existence?

A. No, I did not.

Mr. Winter: She has both the 1942 returns, the original and amended.

(Testimony of Rosalie Novak.)

A. No, I have just one. There is just one here. 1942, Ross B. Hommand.

Mr. Bischoff: I show you the return for 1943 for Ross B. Hammond and ask you whether you prepared that return? [231]

A. Yes, sir, I did.

Q. Was that submitted to Mr. Jacob for approval?

A. Yes, and he has signed this one.

Q. Was it in the course of the preparation of that return that the partnership was disclosed?

A. The preparation and events leading up to the preparation, yes.

Q. What was said with respect to the 1942 return at that time, and when you were informed of the partnership?

A. Well, it was realized they were made incorrectly and that they should be amended.

Q. Was an amendment made at that time?

A. They were amended and they were filed at the same time as the 1943 returns, and we had gotten an extension, I believe.

Q. At the time of the preparation of the 1943 returns, was the partnership interest of William A. Hammond reflected?

A. When the return was made for 1943, I am sure it was divided on a 75-25 per cent basis.

Q. In connection with the preparation of the 1943 returns, were partnership returns prepared for the years 1942 and 1943? A. Yes.

(Testimony of Rosalie Novak.)

Q. I show you these two returns and ask you if those are the returns prepared for the partnership at that time?

A. Yes, these are the returns.

Q. Did you prepare those? A. Yes. [232]

Q. In those returns did you reflect the respective interests of Ross B. Hammond and William A. Hammond?

A. Yes. Took for Ross B. Hammond, 75, and William A. Hammond, 25 per cent division.

Q. When you came to work at the Ross B. Hammond Company in February, 1942, upon what basis were the accounts kept, as you found them?

A. Do you mean upon the accrual basis? Is that what you mean?

Q. I want to know whether they were kept on a cash or accrual basis?

A. On an accrual basis, both personal and the company, and of course they were all the same.

Q. Did you make any change in the method of keeping accounts after you took charge of the book-keeping? A. No, I didn't.

Q. Were those accounts kept in the same way consistently during the time you were there?

A. Yes, to the best of my knowledge they were kept exactly the same way.

Mr. Bischoff: Your Honor, we have some very bulky exhibits I want to call her attention to. May I just refer to them first here at the table?

Q. Miss Novak, I call your attention to these two large books [233] which have been marked Plaintiff's Exhibits No. 23-A and No. 23-B. I will ask you to state what those two books are.

(Testimony of Rosalie Novak.)

A. Those are the journals of Ross B. Hammond Company.

Q. What period of time do they cover?

A. I am not real sure, but I believe they start with about 1938 and they must run through to about 1944.

Q. Would you please take a look at them so you can state to the Court accurately as to the period of time they cover.

The Court: We will recess now until half-past one.

(Thereupon a recess was taken until 1:30 o'clock p.m.)

Court reconvened at 1:30 o'clock p.m., Wednesday, January 14, 1948.

Direct Examination—(Continued)

By Mr. Bischoff:

Q. Miss Novak, you have examined these two journals, Plaintiff's Exhibits 23-A and 23-B. Can you now tell us the period of time these cover?

A. From through the year 1930 and through the end of 1944.

Q. From 1932-1944, inclusive? A. Yes.

Q. Do those journals contain entries of the operations of the business during that period of time?

A. Yes, they do. They are complete. [234]

Q. Did you, during the period of time you were employed by the firm, make the entries in those

(Testimony of Rosalie Novak.)

journals, or were they made under your direction?

A. They were made under my direction and supervision, although I may have made a number of them myself, a part of them.

Q. I call your attention to this book marked Plaintiff's Exhibit No. 24 and will ask you to state what that book is?

A. This is the trial balance book from 1923, which was not Ross B. Hammond, I don't believe, through the current time, 1947.

Q. Right down to date? A. Yes.

Q. Does it contain the trial balances for the years beginning January 1, 1939, to and including the year 1944? A. Yes, it does.

Mr. Winter: That is Exhibit No. 24, Mr. Bischoff?

Mr. Bischoff: Yes.

A. 24.

Q. Will you state what pages that trial balance include the years beginning January 1, 1939, down to the end of 1944?

A. Well, 1939 begins on page 54 and December, 1944, ends on page 81.

Q. The entries in those trial balances for the period of time that you were in the employ of the Company, are those in your handwriting?

A. No, I don't believe so. [235]

Q. Were they made under your supervision?

A. Under my supervision, yes.

Q. And at your direction?

A. That is right.

(Testimony of Rosalie Novak.)

Q. Where was the information taken for the entries in this trial balance, from what source?

A. From the balances on the ledger.

Q. The trial balance entries, do they reflect merely the amounts of the various accounts as entered at the end of the year, or are the entries made there for shorter periods?

A. It is a monthly trial balance, and then the balance sheet or trial balance at the end of the year.

Q. Are you familiar with what is known as the accrual method of accounting? A. Yes.

Q. Does this trial balance book show what accounts were carried on the books of the company?

A. The headings show all the accounts that we have on the books of the company.

Q. Will you read off, in any one year, the headings of the various accounts that were carried?

A. All of them?

Q. Yes, in any one year.

A. The various bank accounts, the accounts receivable, deposits, petty cash, retained percentages on the various jobs—— [236]

Mr. Winter: Retained percentages on the various contracts?

A. Yes. ——prepaid expense, equipment, automobiles, machinery and equipment, office furniture, accrued payroll, accounts payable, accrued interest, accrued taxes, notes payable, bonuses payable in one year, reserve for depreciation; social security deductions, state industrial accident deductions, capital account, interest, income, miscellaneous income, various overhead expenses.

(Testimony of Rosalie Novak.)

Q. Have you read all the account headings that were carried in the books of the company?

A. I did not read each one separately. I grouped a part of them.

Q. Was the same list of accounts carried in each of the years from 1939 down to and including 1940?

A. Yes.

Q. 1944, I should say? A. Yes.

Q. They may have had to do with a different job or something, but they are substantially the same, the headings were the same? A. Yes.

Mr. Winter: Is there any reason for excluding 1938?

Mr. Bischoff: I am doing the examining and I am seeking certain information, Mr. Winter. If there is additional information, you are welcome to have it. She is here and the books are here.

Q. From the list of accounts that you have read off and as they [237] were maintained on the books, are you able to state whether or not those are the accounts that are usually set up under an accrual system? A. Yes.

Q. During the years that you were employed by the Ross B. Hammond Company, did you supervise the making of income tax returns?

A. I made them mostly myself.

Q. And, then, did you submit them for approval to anyone else in some of the years?

A. Usually, Mr. Jacob's office, in this case, assisted in the computations particularly.

(Testimony of Rosalie Novak.)

Q. But you made up the information from which the amounts were determined?

A. Yes, I made that up.

Q. Were these income tax returns made, prepared and executed in accordance with the books as they were kept? A. Yes, they were.

Q. Was there any departure in any of these years I have mentioned from the books in making those returns? A. No.

Mr. Bischoff: At this time we offer in evidence pages 54 to 81, inclusive, of this Exhibit 24.

(Pages 54 to 81, inclusive, of Trial Balance Book thereupon received in evidence and marked Plaintiff's Exhibit No. 24.) [238]

Q. (By Mr. Bischoff): I now show you Exhibit 25 and ask you to state what this book is?

A. This is the ledger of Ross B. Hammond Company.

Q. I beg your pardon?

A. The ledger of the Ross B. Hammond Company, the general ledger.

Mr. Winter: I couldn't hear the answer.

A. The ledger.

Mr. Winter: Of Ross B. Hammond Company?

A. The general ledger of Ross B. Hammond Company.

Q. (By Mr. Bischoff): What period of time is covered by that ledger?

A. 1938 up to date.

Q. Was that ledger kept by you or under your supervision and control?

A. Kept personally by myself.

(Testimony of Rosalie Novak.)

Q. That is, you made the entries in there along with other people in your office? A. Yes.

Q. Your staff of bookkeepers? A. Yes.

Q. From what records were the entries made in this ledger?

A. From the journal, which is on the desk there.

Q. Is this the ledger from which the entries were made in the trial balance book, part of which has been marked Plaintiff's Exhibit No. 24? [239]

A. That is right.

Q. Were the income tax returns made on the basis of the figures disclosed by this ledger?

A. Yes, they were.

Q. Miss Novak, I show you this bundle of folders that has been marked Plaintiff's Exhibit No. 21, for identification, and ask you to state what this bundle of folders contains?

A. This contains billings or estimates, as it may be, on all the jobs concerned in the years 1941, 1942 and 1943, I believe, starting—Shall I list the jobs?

Q. Are you familiar with the jobs or contracts involved in this tax litigation? A. Yes.

Q. Are those the folders that contain all the billings that were rendered in connection with these jobs?

A. There are only two jobs, I believe,—215 was mentioned but that was on a different basis; there were no estimates whatsoever; in fact, we did not pay the bills on it. It was a cost-plus deal.

Q. You mean that there are two folders there that are included that are not involved in this litigation?

(Testimony of Rosalie Novak.)

A. There are a couple of jobs on which we did not have the bills, and that is No. 215, Northwest Ice, on which they paid all the bills except labor, and we were just reimbursed on the labor. Strictly cost plus a fee. [240]

Q. There were no monthly billings—

A. No monthly billings.

Q. But it does contain bills rendered——

A. On any contract job or jobs on which we had any basis to bill. I believe No. 211 was this University Homes, on which the files are terrifically big. That was also a cost-plus-fee job.

Q. Wherever there are billings, are these duplicates of the ones furnished to the Government agencies when bills were rendered?

A. Yes. These are the duplicates.

Q. By whom were they prepared, the final bills that were rendered to the Government agencies? Who prepared them and got them up?

A. Mr. Petersen, Mr. Mason or William Hammond would have prepared them originally and, then, of course, they were typed up by the general office.

Q. Did you examine them before they went out? Did they pass through your hands?

A. Yes, I saw that they were checked and already to go out.

Q. You checked them before they went out?

A. Yes.

Q. Did you make the book entries on these billings as they went out?

(Testimony of Rosalie Novak.)

A. Either made or supervised the entries, yes.

Q. They were made under your direction, then?

A. That is right.

Q. I hand you Plaintiff's Exhibit No. 35 and ask you to state [241] what that record represents?

A. This represents a breakdown of the capital and drawing accounts between W. A. Hammond and Ross B. Hammond.

Q. In whose handwriting is that record?

A. That is in my handwriting.

Q. When did you make the entries that appear upon that record?

A. Started making them in 1943, I imagine, when we first made the partnership returns, and ever since.

Q. When you learned of the existence of the partnership, you set up that account?

A. Yes.

Q. And you have maintained it, in fact, ever since?

A. Maintained it in what?

Q. You have maintained it from that time on?

A. That is right.

Mr. Winter: Is that Exhibit 35?

Mr. Bischoff: Yes.

Q. Where was this maintained? Of what record is it a part?

A. It was kept in my own files which were—which I had in connection with making the returns and financial statements, and what have you.

Q. A miscellaneous file of your own?

(Testimony of Rosalie Novak.)

A. My own personal returns in support—my own personal files in support of the tax returns, and what have you.

Q. What I am trying to find out is: Was this page a part of [242] any book?

A. No, it was not; just in a folder that I had.

Mr. Bischoff: May it please the Court, I have two or three questions to ask the witness which I wish to ask without waiving our objection that we made to evidence introduced by the defendant with respect to the Mason and Petersen deductions.

We have been taking the position, as your Honor knows, that those are not issues in this case and that they have been disposed of by your Honor's ruling, but the evidence was allowed to go in on that subject, subject to objection.

I don't know at this time whether your Honor will rule that the issue is or is not before the Court and, so, I think it is necessary to introduce some evidence in connection with that, without waiving the objection that I have made or conceding that it is an issue in the case.

Q. Miss Novak, were you aware of the profit-sharing agreement between or with Mason and Petersen? A. Yes, I was.

Q. With Mason and Petersen?

A. Yes, I was.

Q. You know what share of the profits each of them was to receive? A. Yes, sir, I do.

Q. Did you make entries on the books or cause to be made entries on the books of the company

(Testimony of Rosalie Novak.)

reflecting their share of the profits at the end of the years 1942 and 1943? [243]

A. Yes, at the end of all years from 1942 on.

Q. The computation of their shares of the profits, was that made on the same basis that you determined the profit of the firm?

A. Well, those were determined from the profits of the company, without any allowance for Petersen, for salary for Petersen or Mason?

Q. The method of determining the total profit of the business, was that the same method that was employed in determining Petersen's and Mason's share?

A. Yes.

Q. Were their shares of the profits determined before or after deducting State and Federal income taxes?

A. There was no deduction for any State or Federal income taxes.

Q. I show you Exhibits 31 and 32, for identification, and ask you if these are the records on which you made the entries of their shares of the income for the years 1942 and 1943?

A. These are the accounts payable sheets, showing the amounts due them.

Q. Were those entries made by you, made or supervised by you?

A. Yes.

Q. Are any of the entries in your own handwriting?

A. They are.

Q. In your own handwriting?

A. Yes, a few of them are. [244]

Q. Were the shares of the profits determined

(Testimony of Rosalie Novak.)

in those two years for Petersen and Mason paid to them at any time?

A. They received a drawing account and, then, in addition, Mr. Petersen has been paid in full. Is that what you mean?

Q. Yes. I want to find out if all the profits which were credited to them were paid?

A. Mr. Mason has been paid in full.

Mr. Winter: We will object to it, on the ground, your Honor, it is incompetent, irrelevant and immaterial if they have been paid now. The question is whether they were paid in 1942 or 1943, the years here involved.

The Court: Answer.

A. They have been paid in full as of now, as of those dates.

Q. (By Mr. Bischoff): Will you state the dates of payments that were made to Mason?

A. In December, 1942, he received a total—received total actual cash of \$10,000, and December, 1943, he received actual cash of \$10,000, and the rest was set up as an account payable.

Q. Were there subsequent payments made to him?

A. Yes, he received \$10,000 also in 1942; \$12,500 in 1945; and in 1947 he received \$40,000.

Q. Give us the dates of the payments in 1947.

A. January 14, 1947, \$20,000.

Mr. Winter: January what?

A. January 14, 1947, \$20,000; July 15, 1947, \$20,000; January 7, [245] 1948, \$49,758.28.

(Testimony of Rosalie Novak.)

Q. Did that close out his account?

A. He is paid in full, yes.

Q. Is Mr. Mason still associated with the firm?

A. He is no longer with the organization.

Q. When did he leave his employment?

A. December 31, 1946.

Q. Were payments made to Petersen on account of the profit-sharing arrangement?

A. Mr. Petersen received \$7,500 in 1942, 1943 and 1944; for 1945 he received \$12,500; 1946, \$17,500; and in 1947, he got \$35,000.

Q. Give me the date in 1947.

A. December 31st.

Mr. Winter: December 31st?

A. Yes, 1947.

Mr. Bischoff: I offer in evidence Exhibit 31 and 32, subject to the reservation that I made, your Honor, that we did not waive our objection.

Mr. Winter: We would like to ask the witness one or two questions about these exhibits, before they are received.

The Court: Proceed.

Mr. Bischoff: I omitted to ask one more question that should have been asked.

Mr. Winter: Yes.

Q. (By Mr. Bischoff): Miss Novak, do you know whether these payments [246] that you have testified that were made were made in cash to these people?

A. Yes, they were; they were made in cash. They were given checks, and they were deductible within the years specified.

(Testimony of Rosalie Novak.)

Q. (By Mr. Winter): Miss Novak, you are referring to Exhibit 35. Where were those sheets taken from?

A. What is 35?

Q. Those are the sheets you have there?

A. This is 31 and 32. Is that what you mean? 35, I believe, is the sheet that you have there.

Q. May I see the sheets, the exhibit?

A. Yes.

Q. Just tell me where you took these sheets from and in what book they were kept?

A. They were taken out of the accounts payable breakdown ledger.

Q. Is that a running account payable of all accounts payable?

A. The book that that is in, I believe, only contains current overhead. We kept each job separately, the accounts payable on each job separately.

Q. When a job is completed, the record in that book is written into the general ledger or journal?

A. No. This is a breakdown of the accounts payable account in the general ledger.

Q. It is a memorandum account, isn't it?

Mr. Bischoff: Let her finish. [247]

A. Pardon?

Q. (By Mr. Winter): That is a memorandum account book?

A. Well, accounts payable book, breakdown book, and each job is kept separately.

Q. In other words, it is a subsidiary ledger to the general ledger?

A. Well, it would be classified as such.

(Testimony of Rosalie Novak.)

Q. When a contract is completed, the sheets from this book are taken out and destroyed?

A. They are not destroyed. When the accounts are all paid on that particular job, they are filed in with our job account. We keep all our files separately on each job.

Q. Are there any records in that book you took it from prior to 1945?

A. Yes, the overhead section is kept—I mean, if we had an account that we had in 1938 and still have it currently, that is in the overhead section.

Mr. Winter: That is all.

The Court: Admitted.

(Subsidiary ledger account of A. V. Petersen thereupon received in evidence and marked Plaintiff's Exhibit No. 31.)

[Printer's Note]: Plaintiff's Exhibit No. 31 is set out at page 648.

(Subsidiary ledger account of H. M. Mason thereupon received in evidence and marked Plaintiff's Exhibit No. 32.) [248]

[Printer's Note]: Plaintiff's Exhibit No. 32 is set out at page 649.

Mr. Winter: One other question, your Honor.

Q. Was the drawing account of Mr. Mason and Mr. Petersen shown in any other book other than that accounts payable ledger?

A. Drawing account?

Q. Yes.

A. During the year it is put under "Office Salaries" and then, at the end of the year, it is reversed.

(Testimony of Rosalie Novak.)

Q. You mean, reflected in office salaries on each particular job?

A. No, it is under "Overhead," not on each job.

Mr. Bischoff: I wanted to ask another question or two.

Q. Miss Novak, when you made up the bills for the monthly estimates, you of course observed the way they were gotten up and what items were included in them? A. Yes.

Q. Do those billings include the amounts that were due but which might be deducted as retained percentages?

A. The accounts in all cases show the gross billing. That is, it shows the retained, 10 or 15 per cent, whatever it might be, with the net amount that they are to pay right now.

Q. Did you set up in an account also the retained percentages which had been earned in that year?

A. The retained percentage is set up in the retained percentage account and the balance is in the accounts receivable.

Q. The amount of your billing, then, is split up in two parts, so to speak, am I correct? [249]

A. We have a gross amount and then against that is the retained percentage in the current accounts receivable.

Q. Did the gross billing go into the income in each year in your book entries?

(Testimony of Rosalie Novak.)

A. Yes, the gross billing is set up as income to the job, and the others are on the accounts receivable basis, although the retained percentage we cannot get right at the moment.

Mr. Bischoff: That is all.

Cross-Examination

By Mr. Winter:

Q. I think you stated you worked for Mr. Jacob, counsel for the plaintiff here, from August 3, 1937, to May, 1940, is that correct?

A. Approximately that. I don't remember the exact dates.

Q. In the capacity as a bookkeeper?

A. I was the only girl in the office at that time.

Q. Well, did you keep his personal set of books or keep clients' books?

A. I didn't actually keep any separate books for any client, no.

Q. Did you have any work in connection with Mr. Hammond's books during any of that time?

A. Mr. Jacob, I believe, was handling his work at that time and I may have typed up some returns. I don't remember that particularly.

Q. You say you went to work for Mr. Hammond February 1, 1942? [250] A. Yes.

Q. And two days later you took the acknowledgment of Mr. Mason on Plaintiff's Exhibit No. 4 (marked as Defendant's Exhibit No. 4), which is the agreement of employment, is that right?

A. Yes, I did.

Q. And you took the acknowledgment of Mr. Petersen on Exhibit No. 5? A. Yes.

(Testimony of Rosalie Novak.)

Q. His agreement of employment for a percentage of the profits? A. Yes.

Q. You took an acknowledgment of the Articles of Partnership on the same date, is that right?

A. Took acknowledgment of the signatures, yes.

Q. Just of the signatures? I didn't ask you that. I said, you took the acknowledgment, didn't you?

A. Yes, sir, I did.

Q. You took acknowledgment of the power of attorney, which is on one sheet, on the same date?

A. Yes.

Q. And you took the acknowledgment of the bill of sale from Mr. Hammond to his son on the same date? A. Yes.

Q. Were they all present at the time the acknowledgments were taken, Mr. Hammond, his son, Mr. Petersen and Mr. Mason?

A. You mean at the same time? [251]

Q. Yes.

A. Well, Mr. Petersen would have been in my presence, Mr. Mason would have been in my presence and Mr. Hammond—Both the Mr. Hammonds would have been.

Q. I just want you to look at Plaintiff's Exhibit No. 3. Notice the signatures of the parties are in different ink?

A. Yes, so is mine. All three are in different ink and different pens.

Q. All the other exhibits seem to be in the same ink, your signature and all appears to be in the same type of ink?

(Testimony of Rosalie Novak.)

A. I don't know. I would have to look at that.

Q. Just take a look at it?

A. They are all made with a different pen.

Q. The signatures? A. Yes, all three.

Q. All three with a different pen on the same date, by you, is that right?

A. Beg your pardon?

Q. All of your signatures are made with a different pen?

A. They are all with a different pen. They all have a different type of pen.

Q. You mean your signatures?

A. My signature, Mr. Petersen's, and Mr. Hammond's and Mason's.

Q. What about yours? Are all of yours made with the same pen? A. Yes, I believe so. [252]

Q. It would appear so, wouldn't it?

A. Yes.

Q. You will notice the words "Subscribed and sworn to" on Exhibits 4 and 5, the words "Subscribed and sworn to before me, the undersigned, a notary public, this" blank day of blank. It is double-spaced, isn't it? A. Yes.

Q. Except in the partnership agreement, it is single-spaced, isn't it?

A. That is a large one and probably it was done to get it all on one page.

Q. Just look at it and tell us whether or not it was on there at the time it was signed.

A. I would say it was.

(Testimony of Rosalie Novak.)

Q. It would have been impossible to have put it on double-spaced, wouldn't it, unless it had been put on at the time the instrument was drawn?

A. Well, it would have been possible at any time to put it on the same sheet, double-spaced.

Q. You want the Court to understand you knew nothing about these agreements, is that it?

A. That is right.

Q. And the first time you knew anything about this particular agreement (Plaintiff's Exhibit No. 3) was late in December, I think you said, of 1943, or March of 1944, when the 1943 tax [253] returns were due?

A. That is right.

Q. Two years later, is that right?

A. Yes.

Q. That is the first time you knew anything about it?

A. Yes.

Q. And yet you say that you did acknowledge their signatures on the date it bears?

A. Yes.

Q. Just take one further look at that. Will you notice that the agreement is drawn with the top sheet and the bottom sheet appearing to be written on paper different from the second and third sheets. Just hold that up to the light and see the watermarks. Are there any watermarks on the front sheet? Look at the second sheet now.

A. There is a watermark on there.

Q. There is?

A. They are both "Success Bond," the first and second sheets.

Q. Look at the last sheet.

A. That is "Success Bond" also. It is in a different position on the page.

(Testimony of Rosalie Novak.)

Q. Did you have that kind of paper in your office? A. I don't know. I don't remember.

Q. What?

A. I don't know whether we carried it or not.

Q. Did you type the agreement? Did you write up the agreement? A. No, I didn't.

Q. Did you write the Mason or Petersen agreements? A. No.

Q. Did you write the bill of sale? A. No.

Q. You knew there was a bill of sale at that time that was executed, didn't you?

A. Yes, but I wouldn't know what the bill of sale covered.

Q. And you knew there was a power of attorney executed at that time, didn't you?

A. Yes, but we have had several powers of attorney on different deals.

Q. When you computed the profit at the end of 1942, and the 25-per-cent profit which was to be computed for the son, how did you arrive at the basis of computing that profit on the return?

A. Well, the drawings had been—I was advised—Wait a minute. How did I figure 1942?

Q. Yes. How did you figure Mr. Hammond was only entitled to 75 per cent of the profits, on what basis? A. In what year?

Q. In 1942, when you prepared the 1942 return?

A. I think it is just mentioned, that 75, isn't it? I don't believe—Wait a minute.

Q. Yes. [255]

(Testimony of Rosalie Novak.)

A. Mr. Hammond had advised that Bill was on a percentage basis and, since his drawing was the same as Petersen's, I had assumed that his was the same, and I had assumed that it was like this.

Q. In other words, Mr. Hammond then told you Bill was on a percentage basis in 1942, is that right?

A. Yes, I am quite sure.

Q. You did not set up any capital account for Bill, but you set up the percentage on the books, didn't you?

A. Yes, because I had assumed that his was the same as Petersen's.

Q. You acknowledged the agreements all on the **same date**. Was there a percentage-of-profits agreement with Mr. Hammond, I mean with Bill, that was signed on the same date also?

A. Not that I had known of.

Q. Not that you had known of?

A. No, but that was about the same date I came there and——

Mr. Bischoff: Let her finish her answer.

A. Anyway, it was about the same date I came and when you are new on a job, you don't know what things are, particularly, and, as far as I was concerned, I was the notary and I was acknowledging the signatures on this agreement.

Q. How many acknowledgments did you take that day?

A. I couldn't possibly tell you how many acknowledgments I took that day.

(Testimony of Rosalie Novak.)

Q. Then you would not know whether there had been any change in [256] that agreement, whether any pages had been added or subtracted, because you only looked at the signatures on the bottom?

A. As far as I am concerned, when I acknowledge it, I am concerned with the signature.

Q. Do you know how many sheets were in the paper at that time?

A. No, I wouldn't say that I do.

Q. You would not know whether the first sheets were the same sheets that were on there when you took the acknowledgment, would you?

A. No, I couldn't swear.

Q. You would not know it because you do not know what was in the instrument? You did not know, did you?

A. No. Well, if you will refer to the Articles of Partnership——

Q. Yes. A. Well, I don't——

Q. Did Mr. Hammond tell you at that time that Bill was now on a percentage-of-profits arrangement with him?

A. Not at that time. If he did, I would not have been particularly concerned until the end of the year anyway.

Q. But he told you, didn't he? You knew Petersen and Mason were on a percentage-of-profits basis as of that time, right then, didn't you?

A. Well, I wouldn't say that I did right then, no.

Q. When did he tell you that his son was on a

(Testimony of Rosalie Novak.)

percentage-of-profits basis and not a partnership basis? [257]

A. I couldn't answer that. I don't know.

Q. At no time until at least the late fall of 1943 or March, 1944, did you ever set up a capital account or a partnership account for Bill on the books, did you?

A. Well, on the general books there wasn't designated any partnership account.

Q. Just refer to William's drawing account in the books. Will you show it to us, please?

A. The drawing account on the books?

Q. Yes.

A. It does not start until later.

Q. Just show it to us, Miss Novak.

Mr. Bischoff: Let her answer.

A. It does not start until either '45 or '46 but, as was explained, it was to be kept secret from the girls in the office as well as anyone that might have had access to the books. That is the reason that was not set up on the books.

Q. Did you know it was a secret back in 1942?

A. I didn't know there was any secret at all.

Q. How did you know it was supposed to be a secret, if you did not know anything about it?

A. I did not know it in 1942. That is what I am talking about. I said up until 194—I don't know the year, 1945 or whatever it was, there was no partnership drawing account set up on the books for W. A. Hammond. [258]

(Testimony of Rosalie Novak.)

Q. Miss Novak, just show us in the books where the drawing account is or any capital account or any account with Mr. William A. Hammond.

A. There is none for the capital account, and that has been kept on that breakdown on Exhibit 35.

Q. You have a drawing account on the books for Bill Hammond. Will you get it and show it to us, please? A. Shall I come down there?

Q. Yes, if you will, please.

A. The current drawing account is not here. It must be on the back of that sheet. That is the accounts payable sheet there, both of those, Petersen and Mason—it is not in here.

One of the girls got some of the current, definitely current accounts, out, and they must have been on the back of Mr. Hammond's current drawings, unless it is misplaced someplace.

Mr. Winter: I would suggest, Counsel, you let the witness answer. If she cannot find it, she can tell us that they don't have such an account.

A. We do have such an account.

The Court: You can look for it at recess. Come back and finish your testimony. Have you some more questions?

Mr. Winter: Yes, Your Honor.

Q. Showing you what has been marked Exhibit 35, you say that record was kept in accounts payable, is that right? [259] A. No.

Q. Where is that record from?

A. This is a record that I had in my own personal files.

(Testimony of Rosalie Novak.)

Q. It was not a part of the records of the company?

A. The only way it was a part of the records is that it was a breakdown of the capital and drawing accounts between the two partners.

Q. And that was prepared by you in December, 1943, or 1944, when you were informed of the partnership? A. The amended return——

Q. Whose amended return?

A. The partnership amended return; I mean the partnership return for 1942.

Q. The delinquent return for 1943 and the—the delinquent return for 1942 and the 1943 return?

A. Yes.

Q. Did you file an amended return for Mr. Ross B. Hammond? A. As I remember.

Q. As you remember what?

A. As I remember, we did file an amended return.

Q. What change was made in the amended return, if you remember?

Mr. Bischoff: The returns are all in evidence.

Mr. Winter: No, they are not all in evidence.

Mr. Bischoff: All the returns are here. The 1942 return and the amended return for 1942 and the 1943 returns are all in evidence [260] for Hammond and for the partnership and for Bill Hammond.

Mr. Winter: Q. You say you filed an amended return for Ross B. Hammond for 1942?

A. I don't remember.

(Testimony of Rosalie Novak.)

Q. You don't remember? A. No.

Q. Did you prepare the original return?

A. Yes.

Q. Did you file an amended return or prepare an amended return for Mr. William A. Hammond?

A. Yes.

Q. What would be the reason for filing an amended return for Ross B. Hammond for 1942?

A. Well, there possibly was not one filed. I just don't remember.

Q. Would there be any reason for filing one?

A. Well, I guess not. I couldn't say. I would have to check on it. I couldn't say offhand.

Q. What?

A. I couldn't say offhand. I would have to check, but I believe—

Q. There was deducted from Ross B. Hammond's return for 1942 a percentage of profits which you, in 1944, credited to Mr. William Hammond, isn't that right?

A. Well, I believe that there was, as I said, on the basis of [261] the contract—on the basis of the agreement with Petersen, and I assumed it was on the same basis. I think the return was made, making the allowance.

Q. Where did you get the information to make the return in the first instance allowing a partnership profit to Mr. Hammond in 1942?

Mr. Bischoff: Objected to.

A. It was not a partnership profit.

(Testimony of Rosalie Novak.)

Mr. Bischoff: Object to the question. He was talking about Petersen, and not Ross B. Hammond.

Mr. Winter: You mean to tell us the partnership profit was not deducted from Ross B. Hammond's return, the partnership profit which was allegedly due William A. Hammond?

A. In 1942 we are talking about?

Q. Yes, 1942.

A. I am afraid I don't know exactly what you mean.

Q. What percentage of the profits already made for 1942, according to the books of the company, did you use in preparing his 1942 return?

A. As I remember, I did prepare it on the basis of an individual ownership, which was my assumption, and that is the way it had been done in previous years, and since William Hammond, according to my understanding, which was incorrect, had a drawing on the same basis as Petersen, I was assuming that that was 15 per cent the same as Petersen's which is 15, and that is how that was split. [262]

Q. Just look at the return and tell us—Where is the 1942 return? Just look at that return, which is for the year 1942, Ross B. Hammond's return for 1942, and tell us what part of the partnership income was reported by Ross B. Hammond on his return?

A. I couldn't tell it from looking at the return.

Q. Can you compare it with the books and tell us from the books?

A. Well, it would be on the basis of——

(Testimony of Rosalie Novak.)

Q. In other words, did you report 85 per cent or 75 per cent of the partnership profits?

A. I don't know. I would have to calculate it in order to get the exact percentage.

Q. What was the percentage to Mr. Mason?

A. Mr. Mason got 20 per cent.

Q. And Mr. Petersen got 15 per cent?

A. 15.

Q. What did you understand Mr. William A. Hammond was going to get?

A. Since it was on the same drawing, I assumed that it was 15, the same as Petersen's.

Q. When did you later find out it was 25 per cent?

A. Either late in 1943 or early in 1944, when the 1942 returns were being prepared, and when the amended partnership returns were made, and the split was 75-25.

Q. But you did not prepare any amended return for Ross B. [263] Hammond?

A. I say, I don't remember. I don't believe so, but I don't remember.

Q. As a matter of fact, the books and records—the partnership return will show that Ross B. Hammond reported only 75 per cent of partnership during that year? That is, the way you computed it?

Mr. Bischoff: What are you talking about?

Mr. Winter: Will you state the question to the witness?

A. Will you state the question again?

(Question read.)

(Testimony of Rosalie Novak.)

A. I don't remember whether it was exactly 75 or exactly what it was.

Q. You do not remember very much about this thing, do you?

A. Well, if you had a bunch of figures, well, fired at you, you would not be able to remember it, I don't think.

Q. Did you prepare an amended return for Mr. William A. Hammond? A. Yes.

Q. Did he sign it in your presence?

A. That I don't remember. Is there an acknowledgement required on the return? He may have been in the service and it had to be sent to him. I don't know whether he was here at that exact time or not.

Q. In any event, no capital account was set up on the books of Ross B. Hammond, other than his drawing account? [264]

A. There is a capital account and there is a drawing account.

Q. The capital account, I mean, was not set up until 1944, or late 1943?

A. There has always been a capital account.

Q. For Ross B. Hammond? Excuse me. For William A. Hammond?

A. There has never been a capital account set up, even currently, for William A. Hammond. It is a company capital account and that Exhibit 35 is a breakdown between the portion that is applicable to the two partners.

(Testimony of Rosalie Novak.)

Q. The tax liability was under investigation in the summer of 1944, wasn't it, when the Agent came out there to visit you?

A. I believe it was about August, 1944. I am not sure of the date.

Q. In any event, after you were told that the partnership agreement was entered into, then the pencil notations were made on Exhibit 35, is that right?

A. Exhibit 35 was started after I found out that there was a partnership and that I would have to break down the capital drawing account.

Q. Was that started after the Revenue Agent came out or was it started before?

A. Well, it could have been started before because I would have made it up when we made up the partnership return.

Q. Since 1944 you have added to it, haven't you? A. Yes. [265]

Q. It was in pencil, and you told the Revenue Agent that that was the only record of a drawing account and capital account of William A. Hammond, isn't that right?

A. What is that question?

Q. Didn't you tell the Revenue Agent that was the only record in the books of either a drawing or capital account of William A. Hammond?

A. That was the only record in the books.

Q. And that was in your personal files?

A. The combined capital and drawing account was in the company's books that were handled and could be seen by anyone. That was in my personal

(Testimony of Rosalie Novak.)

files and, as has been brought out before, it was because the partnership was not wanted to be known by some of the parties concerned.

Q. How were the drawings and percentages of the profits set up on the books with respect to Mason and Petersen?

A. What do you mean by how were the drawings set up?

Q. What record is there in the books of the percentage of profits due to Mr. Mason and Mr. Petersen?

A. Well, at the end of the year we computed as to how much was due them and then the amount due them was split up between the various jobs.

Q. In other words, refer to the returns for 1942—Do you have it there?

A. I have the Ross B. Hammond return for 1942. [266]

Q. Will you refer to the return for 1942 and to the schedule attached of the contracts.

A. Yes.

Q. Referring to Contract No. 208, how much of the percentage of profits of William A. Hammond, Mr. Mason and Mr. Petersen were charged to that contract in the year 1942?

A. I couldn't tell from this return. It does not state. It just says "Labor" and then "Materials."

Q. Does your record show what part of it was charged to that contract? A. I think so.

Q. What? A. I think so.

Q. Can you show where that is?

(Testimony of Rosalie Novak.)

A. I will try.

Q. Look at the entry of December 31st in the journal, 1942. Just read these entries. You are reading from the cash journal, Page J-125, is that right?

A. Yes.

Q. Will you just read the entries that you have with respect to Job 208 there?

A. Charged with \$47,254.58.

Q. \$42,000?

A. No, \$47,254.58. Guilds Lake, \$53,307.56.

Q. That is Job No. 210, isn't it? [267]

A. Yes. No. 211, \$39,670.81. Office salaries——

Q. That was \$16,400?

A. \$16,467.51. W. A. Hammond was set up——

Q. It says "A. P."

A. Accounts Payable, overhead section, yes. \$37,129.66 for Hammond, W. A. Hammond; Petersen, \$37,129.56; and Mason, \$49,500.

Mr. Bischoff: December, 1942.

A. December, 1942. Wait a minute. Yes, there is an error in the top of the page. It says "43" but it should be "42."

Mr. Winter: Q. These amounts that you have just read with respect to Contracts 208, 210 and 211 were all deducted or taken as profit——

A. ——to the job.

Q. ——to the job, as reflected in profit shown as to these separate long-term contracts.

A. That is right.

Mr. Winter: If the Court please, I have a type-written copy of the entries shown on page No.

(Testimony of Rosalie Novak.)

J-125. Instead of offering the entire book in evidence, we will offer the typewritten sheet showing the entries to which the witness has just testified.

Mr. Bischoff: I would like to know what the purpose of it is. At present I do not see the materiality. There may be some and if Counsel will state what the purpose of this is and what he claims for it——

The Court: What do you claim for it? [268]

Mr. Winter: If the Court please, it goes to the very issue in this case as to whether or not the plaintiff has overpaid the tax by having taken deductions on his previous return to which he would not be entitled. The burden is on the plaintiff to show that he has overpaid his tax. The whole question is whether the plaintiff has overpaid his tax or not.

The Court: What does this tend to prove?

Mr. Winter: These amounts, the percentages paid to Mr. William A. Hammond, Mr. Mason and Mr. Petersen, were deducted as charged against these particular jobs, and they were not proper accruals.

Mr. Bischoff: On the contrary, they are proper accruals because, at the end of 1942, they recognized the liability to these various people and credited it on the books.

The Court: Do you wish to object?

(Testimony of Rosalie Novak.)

Mr. Bischoff: No, I am not going to object, Your Honor. I did not know what the point was.

The Court: Admitted.

(Transcript of Journal Entry 125 thereupon received in evidence and marked Defendant's Exhibit No. 36.)

[Printer's Note]: Defendant's Exhibit No. 36 is set out at page ~~649~~: 651

Mr. Winter: Q. Referring to the trial balance book, Exhibit 24, does the trial balance book cover also the year 1938 or at the beginning of the operations by Mr. Hammond as an individual?

Mr. Bischoff: Objected to, may it please the Court, as immaterial. [269] None of the transactions in 1938 are involved in the years in question here. Ordinarily, we would not make any objection, except that we are spending a great deal of time. This cross-examination, I think, has now developed into more of a badgering process. 1948 is not involved in any way in this case.

The Court: I won't let the lady be badgered. I think she is doing all right.

Mr. Winter: Q. At what sheet in the book does the trial balance start? A. 1938?

Q. Yes; what page? A. Page 49.

Q. Does the book also include records prior to 1938? A. Yes.

Q. Was the trial balance carried on the same prior to 1938 that it was subsequent to 1938?

(Testimony of Rosalie Novak.)

Mr. Bischoff: Objected to as immaterial.

The Court: Go ahead. We will take a ten-minute recess now.

(Recess.)

Mr. Winter: Q. I think you testified the trial balance records for the year 1938 begin at page 49 and, of course, would go up to the beginning of 1939, which is on page 54.

The Court: What is that all about?

Mr. Winter: I want to show, if Your Honor please, that they carried forward the same accounts in the trial balance that were [270] carried in 1938 at the beginning of the period here. Counsel has gone back to 1939. I think we are entitled to have 1938 in.

The Court: Do you want to go back to '37 or '36? Where is your stopping point?

Mr. Winter: I am only asking whether or not a consistent practice was carried out. This is preliminary to my next question.

The Court: What is your next question?

Mr. Winter: My next question is whether or not the same accounts were carried in 1939 and 1940, 1941 and 1942 that were carried in 1938. I won't go back beyond the period involved in this lawsuit.

The Court: Why go back to 1938? What is the significance of 1938? What significance does 1938 have?

Mr. Winter: Counsel seems to indicate that there is some difference between 1938 and 1939. I don't think there is. I want to find out whether

(Testimony of Rosalie Novak.)

the accounts were handled on the same basis or not. That is the year in which the taxpayer acquired the right to adopt the basis which we are concerned with here. It was the year 1938 when they first adopted that basis and they must follow that basis, and Counsel knows that, because it was the very question that was in issue in Mr. Hammond's own case. There he attempted to change the basis. I am not sure that the case went to the Court of Appeals but at least the Tax [271] Court held that he could not change the basis.

Mr. Bischoff: The very reason we are here in court today is because the Revenue Agent says in his report that we departed from the accrual method of accounting that was employed in 1938 and upon which we made our return in -1938; he says in his report, in so many words, that we reported in 1938 on the percentage basis and from 1939 down to the end of the period involved we reported on the accrual basis and he says that we had no right to do that because we did not get permission to do so subsequent to 1938. Let me read Your Honor his statement. Now, Mr. Winter stands up here and tells Your Honor that there is no difference in the accounting system between 1938 and 1939.

The Court: You can read that later. I want to take up these reports with me this evening. You don't need to read it now. Do you know what the question is, Miss Novak? Ask it again, Mr. Winter.

(Testimony of Rosalie Novak.)

Mr. Winter: Q. You read a few minutes ago, in answer to Counsel's question, the accounts reflected in the trial balance book. Were the same accounts in the trial balance book in 1938?

A. As nearly as I can tell, they are the same accounts.

Q. As nearly as you can tell, they are the same accounts?

A. Accounts receivable, accounts payable, job accounts——

Q. The same system of bookkeeping was adopted in 1938 and continued on through the years, did it not?

A. I was not here in 1938. I couldn't tell you exactly. [272]

Q. From your examination of the records?

A. As far as I can tell, the books were kept the same way.

Q. You say the accounts were kept on an accrual basis? A. I think so, yes.

Q. You are speaking about the accounts?

A. Well, yes.

Q. Is there any record on the books, in any books, of the supplies on hand, the materials on hand in connection with any contract at the end of a taxable year, the taxable year for which no billings had been made?

A. I do not believe there is an account set up in any year.

Q. There is no inventory, as far as you know? As far as you know, the books reflect no inventory showing amounts of material on hand or work

(Testimony of Rosalie Novak.)

in progress at the end of the year, is that right?

A. It seems like, when we were going through them, there were a couple of accounts that had a very small portion spent and there was no way of arriving at a profit.

Q. Were those contracts completed that year?

A. No. It was just the very beginning of the contract; not over a thousand dollars spent on them; there could be no basis for any profit.

Q. That is the only adjustment made in the books with respect to any inventories of material on hand on any job or any work that might have been done on a contract for which no billing [273] had been made, is that right?

A. As far as I know. If there were materials billed, they would appear in the billings.

Q. Were all of the December billings accrued on the books——

A. Yes.

Q. ——in December?

A. Yes, I believe so, yes.

Q. How about the Milwaukie Housing Project, were all of the billings for December accrued on the books?

A. All that we—all that they would accept.

Q. All that they would accept?

A. All that they would accept and that we could collect for at all as of that date.

Q. Were billings made uniformly at the end of the month, or were they made upon completion of some part of the contract for which you were authorized to make a billing?

(Testimony of Rosalie Novak.)

A. Ordinarily, as we went along, it was billed monthly, if possible. Some of them were strung out two months or three months, if there was no basis of collecting it before that time.

Q. Were all the engineer's estimates as of December 31, 1942, or were they at other times during the month of December, 1942?

A. There would be an engineer's estimate every month, I believe.

Q. Were all of the estimates made right at the close of the year or would they be made maybe twenty or thirty days prior to the end of the year? [274]

Mr. Bischoff: That is objected to. I do not think it is proper cross-examination. There are some limits, even to cross-examination.

Mr. Winter: It is important whether the estimates were made as of the first of December or the 31st. Just a minute. I am addressing the Court. We think it is important to know whether or not the estimates were made as of December 31st or whether estimates were made which might be due on the 1st of January. I mean, the 2nd or 3rd of January of the succeeding year.

The Court: Important in what respect?

Mr. Winter: It is important in respect to whether or not their costs that had been incurred and money expended would be included in some billings that would not be billed until the next year and would, therefore, take into consideration, as

(Testimony of Rosalie Novak.)

provided by the Regulations. As the Regulations provide, consideration must be given to those matters.

The Court: The contracts state when estimates shall be made, and at what time, don't they?

Mr. Winter: I don't think so. I think estimates can be made when they submit a claim to the Government.

The Court: What contract are you talking about now?

Mr. Winter: I am talking, generally, about all the contracts. I do not want to go into each particular contract.

The Court: Just take any one contract. There is a pile of them there. Pick out any one contract and see if there is any [275] clause in it with respect to when estimates are made. You look at it. Don't ask me to read it to find a clause in there.

Mr. Bischoff: There is a bundle of them. The contracts are in that bundle.

The Court: Can we agree whether or not it is a fact each contract provides the time that estimates shall be made?

Mr. Bischoff: Yes.

The Court: What is your view about it?

Mr. Bischoff: They require monthly estimates.

The Court: All right. Let us find the clause. You take a typical contract, you and Mr. Jacob, and find the clause as to that.

She was not examined on this in chief, Mr. Winter. You may make her your own witness. This woman is not a contractor or engineer or su-

(Testimony of Rosalie Novak.)

perintendent. She is a bookkeeper. She testified to nothing about this in chief. If you want to ask her about any contract, you get it and hand it to her and give her a chance to answer.

Mr. Winter: In all due respect to the Court, I was going to ask her about the billings which she identified and testified to. I want to ask her about these estimates. That is what I am trying to find out about.

The Court: Did you ever see any of these contracts, Madam?

A. Yes, I have seen them there in our files in the office.

The Court: Were you familiar with them from time to time? [276] A. To a certain degree.

The Court: Do you know what they provided as to estimates?

A. In most of them, you are entitled to make an estimate on the first of the month and your payment would be received, part of them say, within ten or fifteen or thirty or how many days after that, and it has to be accepted by the owner or the owner's representative or engineer.

The Court: In other words, estimates were made monthly, in most instances? A. Yes.

The Court: Do you know of any rule as to estimates being made at a particular time?

A. As I said before, when it was possible, at the completion of a job, when the amount is not very much, or there is a question where they have already refused them, and it would not do any good to submit another estimate.

(Testimony of Rosalie Novak.)

The Court: The same clause would apply as to any other month in the year. December would be the same as any other month in the year under the contract?

A. Yes, the contract in the case of Contract No. 207, which is the Milwaukie Housing Project, in that case it would not have done any good to bill them for that amount because they would not pay it and did not pay it until late in the next year.

The Court: Why?

A. They would not accept it because the work, according to them, [277] was not suitable, and we did not know how much money we would have to spend in order to put it in suitable shape.

The Court: That was the end of the contract?

A. That was the end of the contract.

The Court: There was a dispute at the end of the contract? A. Yes.

The Court: But I mean as to the usual case; December is no different than any other month?

A. No.

The Court: As far as estimates are concerned?

A. That is right, on any of these contracts where we had any lump-sum amount at all.

The Court: Go on, Mr. Winter.

Mr. Winter: Q. Estimates were not made every month, though, were they?

A. In practically all cases.

Q. Well, in some of the contracts, estimates were not made at all during December, though there had been partial work completed on them?

(Testimony of Rosalie Novak.)

A. As I said, in the Milwaukie Housing Project, I doubt very much if there was any estimate in December.

Q. On your books you made no allowance for any amounts for which estimates had not been given, although a considerable amount of work had been expended on the job?

A. If we could not get the money, that is right.

Q. You made all billings which we have referred to?

A. I did not make the billings myself. I typed or had them typed up, but I did check them.

Q. They were under your supervision for figures only?

A. That is, for addition and computation.

Q. You referred to an exhibit, that bundle of papers, Exhibit 21. You say that exhibit includes all the billings or estimates on all the contracts in progress during the years 1941, 1942, 1943 and 1944, is that right?

A. I didn't say 1944, because 1944 is not in question here, is it?

Q. Well, there were some of the contracts that were started in 1942 that were not completed until 1944, weren't there?

A. Yes, that is true, but not any that started in 1944. Those are not here.

Q. You have none of the billings for 1944?

A. Not on any job that started in 1944.

Q. That is what I mean. A. All right.

Q. Any job that started prior to 1944——

(Testimony of Rosalie Novak.)

A. If it started in 1942 or 1943 and was finished in 1944, they are here, I am sure.

Q. All except a few, I think you said. I think you said there were a few exceptions?

A. That is right. [279]

Q. Now, with respect to the drawing account of Mr. Hammond, I show you what has been marked Exhibit No. 33.

Mr. Bischoff: You asked her to look up certain ledger accounts, and they are produced here. The current portion of the ledger was taken out because it was in current use in the office, and it was expected the ledger would be in use here for a long time, so we sent for them. They are here now.

Q. (Mr. Winter): Your counsel has handed me three sheets. However, they appear to be the drawing account of Mr. Hammond for the period of June, 1946, through August 31, 1947, and the securities, stocks and bonds, account, apparently for 1945. I am not interested.

I am interested in any drawing account or capital account on the books back in 1942 or 1943 or 1944.

A. That is not what you asked me for. You asked me for any drawing account of W. A. Hammond in that ledger. I said it didn't start until about 1945.

Q. That is when it was prepared?

A. That is when we started the account that was finally titled "W. A. Hammond."

Q. That was a year after this investigation?

A. I don't remember the date we started it.

Q. I show you what has been marked for identification as Exhibit No. 33. What account is that,

(Testimony of Rosalie Novak.)

A. This was at that time an accounts payable account and any [280] payments made by Ross B. Hammond personally or Ross B. Hammond Company that were applicable to the expense of William A. Hammond were charged to this account.

Q. From what record did you take these sheets, Exhibit 33? A. From the journal.

Q. From the company journal? A. Yes.

Q. In the books of the company?

A. That is right.

Q. That shows the drawing account of Mr. Hammond, does it?

A. The accounts payable account of Mr. Hammond.

Q. It also shows all the drawings he made as against that account? Does it show any reference prior to 1944 to any partnership profits to which he was entitled?

A. It shows no partnership profits at any time, I don't believe.

Q. At the end of 1943 did you accrue in that account any amounts due Mr. Bill Hammond for his profits under the profit-sharing agreement?

Mr. Bischoff: Are you referring to these account sheets in her hand?

Mr. Winter: Yes.

A. Yes, it was accrued on the same basis as Mr. Petersen.

Q. On the same basis as Mr. Petersen?

A. Yes.

Q. And that \$37,000 is in here as due him. How was that computed? [281] What was that computed from?

(Testimony of Rosalie Novak.)

A. That is the figure you had picked out which you submitted in evidence, typed up from the journal page. I don't know what it was.

Q. Page 126-J?

A. I think it was; could be.

Q. You are familiar with these billings and I am not. Will you show us the December, 1941, billing in the case of the Guilds Lake contract, Contract No. 210?

A. If there is one, I will show it to you.

Q. Would you just resume the stand? Take it up to the stand with you. As I understand it, Miss Novak, you have taken from Exhibit 21, which is a bundle of folders, the billings and estimates on the Guilds Lake construction contract, Contract 210. You have it before you? A. Yes.

Q. Will you give the date of the last billing on that contract in December, 1941?

Mr. Bischoff: Do you want December or do you want the last date?

Mr. Winter: I want the last date in December, 1941, of the billings in that case.

Mr. Bischoff: 1941?

Mr. Winter: 1941. That is right.

Mr. Bischoff: They did not start in 1941. [282]

Mr. Winter: What?

A. There was none in 1941. It had not started in 1941.

Q. Are you sure about that?

A. Yes, positive.

Q. I was in error. It was in 1942 and 1943.

(Testimony of Rosalie Novak.)

A. Apparently November was the last one that there is.

Q. November was the last billing?

A. The next one seems to be combined, December and January.

Q. When was the last billing in 1942?

A. I said November 30th, apparently. The next one seems to be a combined one.

Q. Then, a combined billing was made in January of 1943?

A. Probably made in February to include December and January.

Q. Then no income accrued on your books for the month of December?

A. Apparently not.

Q. Just wait until I finish my question. No income accrued on your books from that contract for the entire month of December 1942?

A. Apparently not. There is no estimate to support it.

Q. But all expenses were accrued for that month? A. All expenses, yes.

Q. Yes, but no income reported?

A. That is right.

Q. When would the income be reported on the January billing, [283] which was for December and January, 1943? Would that all be reported in your 1943 return?

A. Apparently it was. The next estimate was for February, covering December, 1943.

Mr. Winter: That is all.

(Testimony of Rosalie Novak.)

Redirect Examination

By Mr. Bischoff:

Q. Pursuant to Mr. Winter's request that he made before the recess to produce the drawing accounts of Ross B. Hammond and William A. Hammond, have you produced those in court here?

A. Yes.

Q. Are those documents here now, available for use?

A. This is the drawing account as started for W. A. Hammond.

Mr. Winter: I want the record to show that I intended to ask for books and records here involved, and these appear to be for 1945, 1946 and 1947 and are not material. Having asked for them to be produced, I now see no materiality and I do not want them.

Q. (Mr. Bischoff): Miss Novak, you have been asked in your cross-examination about an examination of the accounts made by the Revenue Agent, Mr. W. G. Williams. Do you remember that?

A. Yes.

Q. Is that the gentleman who has been sitting here in the courtroom during the trial of this case, next to Mr. Winter? A. Yes, it is. [284]

Q. He was over in your office, the office of Ross B. Hammond Company, making an examination?

A. Yes.

Q. Did you make available to him all the records that he wanted in connection with his examination? A. Anything that he asked for.

(Testimony of Rosalie Novak.)

Q. Did you withhold anything from him that he wanted or thought that was material or necessary at the time?

A. No, I didn't. He wanted to see the books and he saw the books.

Q. Did you give him all the books he wanted?

A. Yes. If there were any other questions he asked, I gave him the information he wanted.

Mr. Bischoff: That is all.

The Court: This item of income that was not shown for December, 1942, what was the amount of that?

A. I don't remember.

The Court: Mr. Bischoff, I am asking you. It occurred at the end of Mr. Winter's examination.

Mr. Bischoff: I did not hear the question, your Honor. I beg your pardon.

The Court: It occurred just at the end of Mr. Winter's examination. He asked about some income that was not shown; the expenses were accrued but the income was not accrued.

Mr. Bischoff: Yes. [285]

The Court: What was the amount of that? What are we talking about? \$50 or \$50,000?

Q. (Mr. Bischoff): Could you tell from the monthly estimates of the Guilds Lake job how much was involved in the monthly estimate made in February of 1943 which included December, 1942?

The Court: Just approximately.

Q. (Mr. Bischoff): The approximate amount.

A. For the two months together, it seems to me—it looks like about \$67,000 for the two months.

Q. Are you able to state from the papers that

(Testimony of Rosalie Novak.)

you have available before you how much of it represented work done in December?

A. No, I couldn't tell you that. I don't know.

Q. Do you know why in that instance December, 1942, was merged with January, 1943, in one estimate?

A. No, I don't.

The Court: Do you have an explanation of it?

Mr. Bischoff: I do not myself, but Mr. Hammond says he knows the reason.

A. The next billing seems to be from—there is only one left after that which seems to be from February 1st to December 17th, so there may have been quite a question.

Mr. Bischoff: We will put Mr. Hammond on the stand to explain that item.

Mr. Winter: In view of the developments, I am going to ask leave to go through every one of the contract involved here [286] and put that information in the record. We have not attempted to reconcile them because we cannot.

The Court: I want it reduced to dollars and cents. That is all I am asking about.

Mr. Bischoff: That is all.

Recross-Examination

By Mr. Winter:

Q. Do you know whether or not in the other contracts the same situation existed as we have been discussing?

A. Milwaukie was the same situation. That was at the end of the year and we could not collect because of the playgrounds, I believe it was.

(Testimony of Rosalie Novak.)

Q. What about Troutdale where you accrued \$1,036,625 in income and accrued \$20,000 more in expenses? Was it the same situation there?

Mr. Bischoff: That has been examined into a number of times, to my recollection. At this time I don't think he should be permitted to go into it further.

The Court: He has not asked her about it.

A. There may have possibly been some billings that could not have been billed.

Q. (Mr. Winter): There was no adjustment on your books or records covering any of the contracts on those matters, were there?

A. Pardon? [287]

Q. I say, there were no adjustments made on your books, so far as accruals are concerned, covering any of these items or any of the contracts?

A. No adjustments?

Q. That is right; no adjustments for billings that could be made that were not made and that were reflected in the next year's income?

A. I don't remember whether there were adjustments made on the contracts. I presume there were, but possibly there were not.

Q. The November 30th, 1942, billing, do you have it? A. Yes.

Q. Where was that entered in the books? Will you show us where it was entered in the books?

A. I imagine at the end of November.

Q. Will you just check it and let us know?

The Court: Look it up some other time. Let us get along. Let it go until the next recess.

(Testimony of Rosalie Novak.)

Q. (Mr. Winter): What was the date of that billing and the amount of the billing?

A. I didn't check it. I will have to have the book again; I mean, the folder.

Q. What was the amount of the billing? Would you enter it on your books as of the date of the billing or when it was paid?

A. It would have been entered on the date of the billing; that is, for the period covered. If it was covering the 1st of [288] November to the 30th of November, it would be entered in November.

Q. You do not find where it was entered on the books? A. I do not find it now.

Q. Would you get the billings for the Columbia Steel Casting plant, the last billing for the year for Job 213, for the year 1943?

A. You say 1943?

Q. That is right.

Mr. Bischoff: What is the number of that?

Mr. Winter: 213.

A. They were billed separately in that case.

Q. When was the last billing in 1943?

A. December 31st.

Q. How much is the amount of the billing?

A. Well, I will have to add them up. There are several different buildings that were being worked on. There was additional work, apparently.

Q. When were those billings entered on the books? A. December 31st, I suppose.

Q. Can you show us in the books where they are entered on December 31st?

(Testimony of Rosalie Novak.)

A. December 31, 1943, by our credit entry of apparently three hundred and some dollars. There is a credit memo. It was credited to the job. Then there was a credit memo that would have reduced the actual billing, a credit from some previous [289] month.

Q. In other words, the billing was reduced by the amount of the credit? A. Yes.

Q. How much is the amount of the credit?

A. \$837.

Q. How much was the billing?

A. \$381 is the amount set up.

Q. The excess amount, then, was not accrued; therefore, not credited prior to the end of the year?

A. There were credits accrued before the end of the year, but there were also some at the end of the year.

Q. The amount of the credits would not be reflected in the income for the year 1943 and still it represents the income for 1942? A. 1942.

Q. Let us take the Northwest Ice Company, the last billings of the Northwest Ice Company.

A. Northwest Ice Company. There is no billing. That is one of the exceptions because it was cost-plus. They were paying all the bills. We had some labor is all, but they paid all the material bills.

Q. You accrued all the labor?

A. Well, we actually paid the labor.

Q. Yet you did not receive payment until——

A. We did not receive it until the very end of the job.

Q. Which was in the next year? A. Yes.

(Testimony of Rosalie Novak.)

Q. You did not accrue that payment during the year 1943, did you? What would the amount of it be? Do you have any record there?

A. Well, it started at \$5,000 and it ended up \$8,900.

Q. You accrued as income \$15,000 in the next year? A. Oh, no. In what year?

Q. In 1944?

A. The Revenue Agent examined the books in August, 1944, and the entries were not all made at that time. 213, Columbia Steel, 215 and 216 were all completed in the next year, but the Revenue Agent did not technically take the figures as they stood on the books at the time of his report or examination.

Q. You reported in your return for 1944——

A. You have not audited the 1944 return. Those are not in question.

Q. Will you refer to Contract No. 208 and give us the last billing, the Troutdale Aluminum Plant, for the year 1941?

A. \$59,000 was the total amount.

Q. When was that billed?

A. December 31st.

Q. Are you looking at the billing or looking at the books? A. Looking at the ledger. [291]

Q. Will you look at the ledger?

A. There isn't a single—there is not just one bill; there are several bills.

Q. Will you look at those bills, please?

Mr. Bischoff: May it please the Court, when Mr. Winter began this line of cross-examination, I did

(Testimony of Rosalie Novak.)

not anticipate the extent to which he would go in conducting it, but I think it is time to call the attention of the Court to the fact that the Revenue Agent's report here has raised no issue about any of our billings. He has accepted all of the income accrued in those various years and predicated his computations upon that information.

When your Honor gets this report and has had time to digest it, you will see that there is no question raised as to any figures involved but, on the contrary, he uses these figures to make his computation.

The only issue that he raises is that he says we should adopt an altogether different basis, a percentage-of-completion instead of the accrual basis.

Now, by this cross-examination he is attempting to challenge the accuracy of these accruals in different years and, it seems to me, he is engaged in an examination that is fruitless for any purpose here. We have no inclination to withhold any information nor to bar any examination, but I think it ought to be within the limits of any issues tendered here. [292]

Mr. Winter: The sole issue in this case, your Honor, is whether or not this taxpayer made proper accruals of income and reported the proper income in this case. That is the whole basis of the Examiner's determination. The accounts are kept on an accrual system but they do not take into consideration the other items which necessarily must be considered, such as this \$59,000 which is reflected

(Testimony of Rosalie Novak.)

in the next year's income. That is the whole issue in the case.

The Court: Gentlemen, from now on you will be required to agree on a pre-trial order before I try a case for you gentlemen again.

Mr. Winter: This case involves about \$175,000.

The Court: I don't care if it involves \$1,175,000. From now on you will be required, before you try a case before me, a tax case before me, to set out in a pre-trial order what the issues are. I don't know what they are.

I heard Mr. Bischoff say, in passing, in his opening remarks, something about some possible errors in the accrual system. His point was that, even though there were errors, that did not vitiate the fact that that was the system in use. As near as I can understand, what you are jangling about now is that you claim the errors are of such magnitude that that does vitiate the system.

Mr. Winter: Yes.

The Court: Since you have not set up your issues, as I [293] shall hereafter require you to do, we will go on and make the best we can of it. Continue with your questions.

Q. (Mr. Winter): Do you have the last billings for 1941 for the Troutdale Aluminum Plant, Job 208? A. These are the billings.

Q. You have them with you? A. Yes.

Q. Would you read off the amount, the dates of the billings and the amounts?

A. December 29th, \$15,676.30; December 31st, \$17,928.94.

(Testimony of Rosalie Novak.)

Q. The next one?

A. December 31st, \$16,783.51; \$323.64.

Q. Where were those amounts accrued on the books? A. Where?

Q. Yes.

A. They were accrued on December 31st.

Q. In what book? A. In the journal.

Q. At page what? A. Journal 1096.

Q. 1096? A. Yes.

Q. Would you just read the entry from the journal so we won't have to have the page marked.

A. Page 1096? [294]

Q. Yes.

A. Each one of these is entered separately and the total is listed in the ledger.

Q. The total is how much?

A. \$59,775.31 was the total accrued to the Troutdale account.

Q. That is the total amount which you reported as income during the year? A. Yes.

Q. Now, go to December of 1942. Before we go there—Well, all right. A. Total \$8,945.30.

Q. What was the date of the last billing?

A. December 31st.

Q. Would you get the billing?

A. There are several billings for that date.

Q. Several billings on the same date?

A. Well, yes, there were. This was not billed.

Q. Those billings were not made at the end of the month? They were made at different times in the month?

A. I guess they were at the end of the month.

(Testimony of Rosalie Novak.)

Q. What are the dates of the billings?

A. Some on the 3rd, some on the 18th.

Q. The 3rd of December, 1941?

A. 1942; and there were some made January 1, 1943. I am not sure offhand where they went. That is apparently for December. [295]

Q. What do you mean by "this"?

A. December 3, December 18 and January 6.

Q. They all went into December of 1942?

A. Yes.

Q. Those billed in January, 1943, went into December, 1942? A. Yes.

Q. What are the amounts that were billed in January that were accrued in 1942?

A. Well, they are relatively small.

Q. Was it the purpose to accrue some billings right after the close of the year back into 1942?

A. They were not made up until January. They were dated in January but they were covering, apparently, December work.

Mr. Bischoff: Talk louder.

A. I said: They were made up just after the first of January and dated in January but they covered December work.

Q. (Mr. Winter): These billings covered different component parts of the contracts?

A. Separate billings. In fact, I think each one of these billings was on a separate bill date. There were, I don't know how many, buildings on the whole job.

Q. If the billing was accrued on December 3, 1942, there might not be a billing on that particular

(Testimony of Rosalie Novak.)

job until January of the next year, nearly two months?

A. In this case it was dated January 6th and another billing [296] was dated February 4th.

Q. As each component part was completed?

A. And as each component part was billable, then it was billed.

Q. Any adjustments made on the books as of December 31st with respect to work which had been completed but for which no billings had been made? A. No, just the billings.

Mr. Winter: If the Court please, I think that is all except I want to examine her about Guilds Lake if she can find the billings on Guilds Lake.

The Court: You look that up and come back for redirect.

Mr. Winter: In connection with the testimony of this witness, we will now offer Pages 49 to Page 54 of the trial balance book, which is in evidence as Exhibit No. 24.

Mr. Bischoff: What is No. 24?

Mr. Winter: That is the trial balance book.

Mr. Bischoff: What are the pages, again?

Mr. Winter: The pages with respect to——

Mr. Bischoff: ——1938?

Mr. Winter: 1938, Pages 49 to 54.

Mr. Bischoff: Object to those, your Honor, as immaterial. Those years or that year, rather, is not involved.

(Testimony of Rosalie Novak.)

The Court: Admitted, subject to the objection.

(Pages 49 to 54, inclusive, of trial balance book thereupon marked as a part of Exhibit No. 24.) [297]

Mr. Bischoff: Is that all?

Mr. Winter: Except for the billings on Guilds Lake.

Mr. Bischoff: Didn't she have those out for you?

Mr. Winter: No. You could not find where it was entered in the books?

A. You said billings?

Mr. Winter: I want the dates when those billings are entered on the books and the amounts.

A. Incidentally, that \$57,000 must have been an error—that is \$67,000.

Q. Tell us the date of the billing and the date entered on the books and the amount. Give us the date of the billing and the amount, first.

A. December 3, 1942, seems to be the billing.

Q. The amount of the billing?

A. The total of the billing is \$126,415.85, less retained percentage. \$126,415.85 was set up.

Q. That was set up on the books as of what date? A. It is here as November 30th.

Q. The billing is dated November 3?

A. December 3.

Q. But it is set up on your books as November 3? A. That is right.

Q. Journal Page 113? 112 or 113?

A. No, 113. [298]

Q. Now, give us the date of the January billing?

(Testimony of Rosalie Novak.)

Mr. Bischoff: January, 1944.

A. February 13, 1943. I read this one incorrectly.

Q. (Mr. Winter): May I see the billing?

A. They must have not paid the month before and that is the reason, \$14,039.15, but I don't see the retained percentage that was collected on this here.

Q. The amount of the voucher is \$67,715.24.

A. That includes \$52,000 of retained percentages which had already been entered as income in the previous year, so for the month of January—\$14,839.15. This other was in error.

Q. Did you accrue the retained percentage on \$67,000 in 1942 then before?

A. That was accrued in 1942, yes. That is always set up as accrued to the job. It is not an account in accounts receivable because it is not due until the completion of the job, but we figure it as income.

Q. Will you point out to me, Miss Novak, where the retained percentage is shown?

A. The retained percentage is not actually shown. The retained percentage represents about five per cent, whereas, in the month before, it was \$107,000—We billed them for \$54,000 each month, December and January, and the next month it was \$19,000 in February—Well, it was not \$19,000 because there was a credit against it later. [299]

Q. What amount do you show as accrued in 1943? Is that the difference between \$54,000 and \$67,718.24?

(Testimony of Rosalie Novak.)

A. Well, in January, \$14,839.15, and we have the same thing the next month.

Q. That exhibit which you handed me shows that the building was not 98-7/10ths completed?

A. That does not mean——

Q. I say, that is what it shows, does it not?

A. That is what it does show because of the amount completed.

Q. In other words, that is the engineer's estimate as to the percentage of completion, the composite percentage of completion of the job?

A. Yes.

Q. It is shown on that exhibit?

A. It says "Percentage Complete." However, that does not mean the actual percentage complete. That is just the actual money.

Mr. Winter: That is all.

Mr. Bischoff: That is all.

(Witness excused.) [300]

ROSS B. HAMMOND

plaintiff herein, having been previously duly sworn, was recalled as a witness on his own behalf and was examined and testified as follows:

Direct Examination

By Mr. Bischoff:

Q. Mr. Hammond, in connection with the Guilds Lake job, Contract 210, it appears that no billing was made for the month of December, 1942, but that a composite or joint billing was made for the month of December, 1942, and the month of Jan-

(Testimony of Ross B. Hammond.)

uary, 1943. Can you explain why that was done in that instance, or the reason for there being no billing in December?

A. It was a very similar case to the Milwaukie Housing Project. As far as we were concerned, we assumed that we were through or practically so, but there developed quite an argument about how we had completed any of the houses on the interior and also whether they were going to accept the sewer system, which was quite a big item, and they refused to recognize the completion on time to permit of billing that amount of work. What those figures were I don't remember at all, but it was a considerable amount because of the large amount of heavy construction, and they did not accept the sewers until, I think—it seems to me it was February, and I think it was considerably later than that when they accepted all the rest, because we argued about it over quite a considerable period of time, and, of course, there was no way of billing it because we could not bill it until we [301] produced the architect's certificate.

Q. They would not issue a certificate in December?

A. Oh, would not issue a certificate at least for any amount that we felt that we were entitled to.

Q. You did not agree upon it and so——

A. We did agree upon it and so he did not pay us.

Mr. Bischoff: That is all.

Mr. Winter: That is all.

(Witness excused.) [302]

A. V. PETERSEN

was thereupon produced as a witness on behalf of the plaintiff and, being first duly sworn, was examined and testified as follows:

Direct Examination

By Mr. Bischoff:

Q. What is your full name?

A. A. V. Petersen.

Q. Where do you live, Mr. Petersen?

A. 625 Southeast 52nd.

Q. Would you please talk louder? A. Yes.

Q. How old are you? A. Thirty-seven.

Q. What is your occupation?

A. General superintendent for Ross B. Hammond Company.

Q. Construction superintendent? A. Yes.

Q. How long have you been in the employ of the Ross B. Hammond Company?

A. About fifteen years.

Q. Continually? A. Yes, sir.

Q. In February, 1942, did you know whether any partnership agreement was entered into between Ross B. Hammond and his son Bill? [303]

A. No, I didn't.

Q. You were not told anything about that in the year 1942? A. No, I was not.

Q. Or 1943?

A. I don't think it was in 1943.

Q. When did you first learn about the existence of a partnership between Mr. Hammond and his son?

A. I believe it was approximately two years or so after—Well, it was about 1944 some time.